HIGH INTEREST RATES AND THEIR IMPACT ON SMALL BUSINESS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON ANTITRUST AND RESTRAINT OF TRADE ACTIVITIES AFFECTING SMALL BUSINESS

OF THE

COMMITTEE ON SMALL BUSINESS HOUSE OF REPRESENTATIVES

NINETY-SEVENTH CONGRESS

FIRST SESSION

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HIGH INTEREST RATES AND THEIR IMPACT ON SMALL BUSINESS

SATURDAY, OCTOBER 3, 1981

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ANTITRUST AND RESTRAINT OF
TRADE ACTIVITIES AFFECTING SMALL BUSINESS,
COMMITTEE ON SMALL BUSINESS,
Cincinnati, Ohio.

The subcommittee met, pursuant to notice, at 9:20 a.m., in the council chambers, city hall, Plum and E Streets, Cincinnati, Ohio, Hon. Thomas A. Luken (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN LUKEN

Mr. LUKEN. We thank you all for attending this session of the Small Business Committee of the U.S. House of Representatives, the Subcommittee on Antitrust and Restraint of Trade Activities Affecting Small Business.

Our subcommittee activities in this session of the 97th Congress, have been devoted to a theme of procompetition. We are interested, as advocates, in the small business community in this country and in business generally, especially from the competition standpoint of promoting prosperity, of promoting growth in our economy, and of protecting against monopolistic practices. In addition, we are also interested in protecting against the incursions of Government agencies and of monitoring Government agencies—in this case Government agencies such as the Federal Reserve and others which affect the growth of the economy. We are particularly looking this morning at the impact of high interest rates on our economy.

Interest rates continue at disastrously high levels. In all sectors of the economy small businesses are financially hurting. We have certainly heard from small businesses, and we have heard from business interests generally here in this commmunity.

Congressman Lyle Williams, who is the subcommittee's ranking minority member, and I have scheduled hearings in our respective districts. We are conducting this hearing in Cincinnati today and we will be in Youngstown, Ohio, on Monday.

In about a week the subcommittee will be in Omaha, Nebr.

This subcommittee, therefore, along with other subcommittees of the Small Business Committee, will probe the causes of and possible solutions to the high interest rate dilemma, because it is having a very adverse effect upon our economy, and particularly upon individuals and small businesses.

That is the purpose of this committee in addressing the problem today.

We have invited a number of witnesses, most of whom have been in regular contact with our office because of the adverse effect of this high interest rate dilemma on their particular businesses. We have given out a list of witnesses that have been invited, and we will certainly hear from anyone else who wishes to testify.

The printed witness list is not in any particular order as to appearance. A couple of people have requested, because of pressing schedules to be called early.

We will begin the hearing by asking the representative of the Greater Cincinnati Automobile Dealers Association, immediate past president, Bob Williams, if he will lead off today.

TESTIMONY OF ROBERT WILLIAMS, IMMEDIATE PAST PRESIDENT, GREATER CINCINNATI AUTOMOBILE DEALERS ASSOCIATION, CINCINNATI, OHIO, ACCOMPANIED BY CARL TEDESCO, EXECUTIVE VICE PRESIDENT

Mr. WILLIAMS. Mr. Chairman, my name is Bob Williams. I am president of Williams Ford Sales and immediate past president of the Greater Cincinnati Automobile Dealers Association. I take great pleasure in addressing you today.

In 1978, the retail automobile industry enjoyed one of its finest years. In 1978, interest rates were not a big factor except for the cost of maintaining vehicles in inventory. In 1978, in the month of August, my interest charge per vehicle in stock was $44.35 per month. This year, in 1981, in the month of August, my interest cost per vehicle in stock has increased to $177, or four times higher than in 1978.

Of course, during this same period we also had two other factors affecting our business: interest rates that the manufacturer pays has forced them to increase the price to us, not only the base price of the vehicle but the transportation charges, accessories, and other items.

During this period of time, the average cost of a new vehicle in stock at my dealership went from $6,015 dealer's cost to $8,777, which is in excess of a 25-percent increase, though we are carrying a much larger number of small, fuel-efficient, less expensive models than we were in 1978.

If we had the same mixture of inventory by model line, I am confident that the increase would represent something closer to a 50-percent increase in costs.

So the cost to floor plan the vehicles has not only gone up but also the cost of the vehicle itself.

We have seen a decline in our sales and, with that, we are now dividing our floor plan, or interest costs, on these more expensive cars by fewer cars sold.

Allow me to point out the following examples.

In 1978, in the month of August, our interest cost per vehicle sold was $96; in 1979, $210; in 1980, $265; and, this year to date, $447. Year to date we are paying $447 in interest for each car we are selling to consumers.

This cost per vehicle, of course, reflects the additional factor of a decline in sales. In the month of August 1981, we sold only 53 percent of the number of cars that were sold in the month of August 1978. It would be foolhardy for anyone to assume that

because we have had increases in interest expenses that we can just very easily pass that on to the consumer. The consumer is aware, and the consumer is prudent in the purchase of motor vehicles, and we must be very competitive.

Now, in order to stay competitive, one must reduce other expenses, and here is where the ripple effect from the high cost of interest causes some serious long-range problems.

In 1978 and 1979 we were stocking approximately 250 to 300 new vehicles, which means we were filling the order blank as the manufacturer and the assembly lines were rolling real well. Today we are stocking less than 100 new cars and only 20 percent of the trucks that we stocked at the peak of 1979.

It is necessary for us to have fewer cars and trucks in stock because of the high interst rates. Because this interest expense represents one of the highest expenses we have in the dealership, it has been necessary to make other cuts. In 1978 I employed 123 employees. Today we employ 59. I have also deferred capital improvements and reduced almost every expense across the board in order to remain competitive.

So we have two situations. One, we must be competitive; and two, we must survive during this period of high interest rates and high inflation. They both become one and the same because if we are not competitive, we will not survive. Cost reduction has been our answer in offering what we consider to be more competitive prices, for we are competing for the consumer's dollar.

After some research, we find most dealers are of the opinion that we could probably live with a 15-percent prime interest rate, but nothing higher.

It is also important for us to let the consumer know that the interest rate he pays on a new or used vehicle loan is considerably less than prime. Prime is not a factor except in our loans from our banks. In fact, the consumer most often buys the car and finances it for 4 or 5 points less than we pay our bank for floor planning that same car in our inventory.

Now I would like to give you our general recommendations for lowering interest rates.

First, that the President and Congress take whatever steps are necessary to hold the budget deficit to under $43 billion in fiscal 1982, and to balance the budget in fiscal 1984.

Second, that the President urge the Federal Reserve Board not to let the restraint of money supply become its exclusive goal. We believe that other agencies and other segments of the economic society should be involved in the restraint of money supply besides just the Fed.

Third, that the Fed should consider the need for a general economic recovery and financial marketplace stability and a constant program of monetary growth within those target ranges reported to Congress for 1981.

Fourth, for the President to appoint a nonbanking small business representative to the Federal Reserve Board. We are convinced that interest rates must decline because the double-edged sword of high interest rates and the high cost of our 1982 model cars is a crippling factor.

I have heard that the automobile dealer's total investment in facilities, equipment, tools, supplies, parts, et cetera, exceed that of any or most of the manufacturers.

In fact, the total employment of all the auto dealers in Cincinnati probably was close to that of General Electric or Ford Motor Co., for we did employ together in excess of 4,500 people. According to the National Automobile Dealers Association, more than 2,500 dealers have gone out of business over the last 30 months, largely due to high interest rates which have not only dampened consumer demand for new automobiles, but have added significantly to dealer operating and floor planning costs.

What I have mentioned up to this point has only been what happens to me as an automobile dealer. In reviewing my checks to be sent out the other night, I noticed just how many small businesses that we do business with and how our volume with them most probably has affected them. We do business with small companies that sell tires, replacement batteries, parts, et cetera. I am very much concerned about their survivorship as well, for they are also our customers.

I would like to thank you for this opportunity to appear before this committee and I hope that my testimony will be of help to the House Committee on Small Business.

Mr. LUKEN. Thank you, Mr. Williams. I think your testimony has been pointed and concise. It apparently covers the range of the most serious aspects of high interest rates and how they affect your particular business, which in turn affects the production of automobiles, steel and all the other accessories and parts that go into automobiles. This in turn has affected the economy of the Midwest, East, and all of the so-called older parts of our country where a good part of the Nation's population lives.

Therefore, what affects your business affects our whole economy. I think we have to realize that. And I hope that we do.

Now, if nothing is done, and if high interest rates continue, say for the next couple of years, can you project how your industry will tolerate this, or will it?

Mr. WILLIAMS. Well, from what we have seen, we doubt that the retail automobile business will be as it was 5 years ago. We don't think we will ever see that again. You can expect if interest rates do not decline, you will probably see a loss of another 2,500 automobile dealers within the next 8 to 10 months. Dealers will be closing. Many of them have been holding on by their fingernails for the last few months, last few years. You will see more of them going out. We will certainly see that especially here in the Midwest.

We have a declining population. We have a larger dealer body supporting that declining population.

Second, I think you will see some changes in the manufacturing end. There may be some serious adjustments there. There is talk today of mergers in some of the large corporations. You will see some possible mergers of the import companies, maybe having a vested interest in some of the larger manufacturers in the United States; Chrysler, Ford.

I think you will see a dramatic change and with it a big impact on the total economy.

Mr. LUKEN. You have made some points with reference to recommendations for some solutions. You have said that the Federal Reserve should consider the need for a general economic recovery and financial marketplace stability, and for the Fed to maintain a consistent program of monetary growth within those target ranges reported to Congress for 1981.

I assume that means the Federal Reserve should not take the strict monetarist view of controlling money, and assuming the full burden of restraint on spending and of inflation that the Fed has pursued.

Mr. WILLIAMS. Yes. You know, in layman's language, they have stuck their nose in a lot of businesses they probably shouldn't be in. And probably the marketplace itself could correct most of its problems if the marketplace was given the opportunity to do it.

Mr. LUKEN. You are talking about automobiles. The policies of the Federal Reserve Board and particularly the policies of this administration have sometimes been characterized, when we are talking about monetary and fiscal policies, as coming into collision. And it has been likened to putting your foot on the gas and the brake at the same time; that is, putting your foot on the brake with these monetarist policies.

On the one hand, with the large tax reductions, large defense spending and other policies in the fiscal area, we are fueling the economy and actually accelerating it.

Yet, on the other side we are trying, with the actions of the Federal Reserve Board strictly controlling the money supply, to put a stop to it.

I think that is basically the problem that we have. We are looking for that magic solution.

Mr. WILLIAMS. Maybe what we need is an automatic overdrive.

Mr. LUKEN. Do you have any questions, Mr. Dalton?

Mr. DALTON. Mr. Williams, how much help was the effort by Ford Motor Credit and GMAC to offer interest rates on financing of a car, such as 13.8 percent?

Mr. WILLIAMS. Dramatic for General Motors. But I am a Ford dealer. It is always a stimulus to the market. That is one of the advantages that the domestics obviously have; that we are associated with our own credit companies: General Motors with GMAC; Ford Motors; Chrysler Credit Corp. They seem to have that ability to give us a little bit of stimulation occasionally. They can help by throwing in some extra money via discount rates. It was a big help. General Motors picked up some additional sales last month as a result of it. Because 13.8 is a lot better than 18 percent.

Mr. DALTON. What is the used car market like?

Mr. WILLIAMS. It has been very good, because there is a scarcity of used cars. The value of used cars has appreciated at least $800 in the past year per unit available in used car lots, because of not having enough new car sales and the high cost of new cars.

Mr. DALTON. Thank you.

Mr. LUKEN. You made the point that the President and the Congress should take whatever steps are necessary to hold the budget deficit in line, or under the $43 billion which was the amount that the administration estimated in its original budget figures.

The problem with any of these considerations is that they are interrelated and interdependent. As long as we have high interest rates, the possibility of keeping the budget deficit to $43 billion is almost out of the question.

I don't know whether enough people recognize this. If you have a $1 trillion national debt, which is awesome and should be reduced rather than augmented, and if we are paying 8 or 9 percent on a trillion dollars, that is one thing. But if we are paying 15 and 16 percent, that is twice that amount needed to finance the debt. The national debt has only gone up proportionately in the last few years. It is really a lot of money; it is three times what it was 12 or 15 years ago. But inflation has almost dictated that, as far as that is concerned, because things cost approximately three times as much as they did 15 years ago.

But the real problem with the national debt is not the $1 trillion, but the 16-percent interest that we are paying on it. And this problem has happened in the last year or so. Therefore, the high interest rate not only is a problem for you, but it is a problem for the Government at that very basic level.

If we got interest rates back to where they were a couple of years ago, we would cut $40 billion off the deficit, or at least $30 billion. And that is what we are talking about as the deficit. The President's original estimates were a $42 billion fiscal debt. At that time many Members of Congress and the Congressional Budget Office criticized those figures saying that they were based upon an interest rate next year of 8.9 percent. People asked at that time: who believes that in 1982 we are going to have 8.9-percent interest. Well, somebody did in the administration back in the spring.

As soon as the budget was in place and as soon as the tax bill was in place, then they no longer purported to believe that.

So we are back to reality, facing higher interest rates.

Frankly, I think that your recommendations here are ones that we should be pondering at all levels of Government.

I thank you very much. Do you have anything else?

Mr. TEDESCO. Mr. Chairman, I would like to add a couple of points.

You might want a little more insight on how many dealers we have lost here over the last, say, 30 months. We have lost almost 10 percent of our dealer body, which was right around 100 dealers 3 years ago. This last month we lost three dealers in this market, and another one sold out to the manufacturer. I would say out of the 4,500 employees that we had 2½ to 3 years ago, we have lost almost 1,000 of them through layoffs and dealer terminations.

In addition to the 10 dealers we have lost in this market, another 8 or 9 have sold out to other interests. They have just given it up and sold out, and were able to sell their businesses.

These are things going on and on.

If this interest rate does keep up, we will see dealers dropping out every month.

Then we have more unemployment. Of course, you don't hear about it, because they are individuals and not GE. The dealers just cannot survive when they are paying 21, 22 percent on floor plan for cars. And with the additional price increases that the manufacturers are putting on every year.

Mr. LUKEN. Would you compare the problems in their importance: the dealer financing and the customer financing. Which is more severe?

Mr. WILLIAMS. Customer financing is more important. This is the unfortunate area, unfortunate problem. The customer has an impression he is going to be paying 21, 22, 23, 24 percent for his money, and he is not. The highest rate allowed in the State of Ohio is 18 percent, annual percentage rate. So the consumer in a sense is paying considerably less than the dealer.

We can control our own internal costs. It is a difficult problem, but we can control it through better ordering of vehicles, having fewer accessories, fewer cars in stock, better expense control internally. But with the consumer having this illusion that he is paying the high rates, he is keeping himself out of the marketplace.

If the prime rate were to drop, even to 15 percent, the chances are that the consumer still would be paying relatively the same rate as today.

The lowest annual percentage rate we have seen in the last 5 years has been 14 percent annual percentage rate on financed contracts in the State of Ohio. So his fear if interest rates go down he should not buy because he would be the last one getting off the bandwagon is not true. The consumer is protected by State law as well as by the prime rate itself.

We just wish more people would realize they are paying less than we are, and prime is not a factor in buying automobiles. If they do, we will sell a lot more cars.

Mr. LUKEN. Thank you for those comments. Your testimony and comments are in the record and we hope they will be a factor in reaching some of these solutions.

Mr. WILLIAMS. Thank you.

Mr. LUKEN. Our next witness is Mr. William Sheehan, executive secretary-treasurer of the Cincinnati AFL–CIO Labor Council.

STATEMENT OF WILLIAM P. SHEEHAN, EXECUTIVE SECRETARY-TREASURER, CINCINNATI AFL–CIO LABOR COUNCIL

Mr. SHEEHAN. Mr. Chairman, my name is William P. Sheehan. I am the executive secretary of the Cincinnati AFL–CIO Labor Council, and I thank you for the opportunity to allow me to express my views on the issue of high interest rates.

If the market existed in a classical form, monetary policy could perhaps operate against inflation without a drastic effect on production. At least, most economists would seem to agree on this point. That is because an increase in interest rates and a drop in bank lending would shrink demand. Prices would stabilize or fall and the effect would be passed along. This is the way markets are meant to work, and this is the way the Reagan administration says it will work. High interest rates and a tight money policy will drive down inflation, they say, and as Mr. Volcker stated before the Senate Budget Committee, "I am confident that as that happens interest rates will come down."

Caught up in all of these rosy predictions and acceding to the wishes of the President, Congress passed an ambitious program of tax and spending cuts. The program, besides promising to accomplish these goals, was a signal that the President and his men had

a firm hand on the rudder of our national economy and this in turn would encourage business growth and investment.

Well, we are obviously not operating in a classical market environment and things simply have not happened the way the President and his advisers said they would.

Evidence of business growth and investment has been missing and with the exception of the past few days stock and bond markets have been in shambles. On the other hand, key sectors of the economy, automobiles, housing, farming, small business, State and local governments and thrift institutions like savings and loans are facing economic disaster.

The tight money policies and high interest rates strike at the heart of the American economy. The high cost of money spreads throughout the economy and is built into the cost of all goods and services. These policies have not only failed; they appear to be the major obstacle to our renewed economic growth. The only booming trend is business failure.

Housing production is reaching its lowest level in nearly two decades. Average mortgage interest rates are approaching 18 percent, and less than 5 percent of the American house-buying public can afford to buy a home. It has been reported that one-third of the Nation's homebuilders have simply left the field.

Some 2,600 automobile dealers have gone out of business and sales were down 3 million from the past decades' best year.

Farm interest rates have skyrocketed, farm debt is at an all-time high, and interest rate costs accounted for about 10 percent of farm production costs in 1980.

The growing layoff lists at GE, Ford, General Motors, and our milling machine industries plus countless of small firms is irrefutable testimony against the high cost of money.

Kenner Toy which generally is booming at this time of the year, this is the first time that employees have gone to the unemployment office in September. Generally that does not happen until November.

The building industry, which had been strong until the past few months, has indeed a very bleak forecast, but I shall let Jim Harlow elaborate on that field.

The Nation's unemployment rate has climbed to 8 percent. Even more alarming, 9.9 percent of Ohio workers are among the jobless today. Cincinnati remains above the national average. Even more dismal is the little prospect for significant progress in reducing sky-high interest rates. With the prime rate in the 20-percent range, with home mortgages hovering at 18 percent, small business and housing will continue to lag. Auto sales are critical.

The big business merger craze diverts credit from productive investment and keeps interest rates high. The push for mergers and acquisitions by giant corporations, using billions of high-cost borrowed dollars, along with the tight money policies, is maintaining pressure on interest rates that will keep them at high levels for the foreseeable future.

Just recently the Congressional Budget Office reported that they expect interest rate outlays to be $40 billion more than administration projections due to the administration's own unrealistic projections of interest rates through 1984. In other projections, the Con-

gressional Budget Office has estimated that if the gross national product falters by just one point below the administration projections, there will be $38 billion less in Federal revenue between now and 1984. In short, the cumulative budget deficits will be increased by $78 billion. The interest on this debt could have disastrous effects.

High interest rate policies must be reduced. They are causing serious damage to our economy.

Back in February, the AFL–CIO called for economic policies to deal effectively and fairly with the causes of inflation and the weaknesses that prolong unemployment.

Following the President's challenge to dissenters to submit a program if you did not agree with his, the AFL–CIO did so. It was detailed and specific. It called for anti-inflation policies dealing with interest rates, housing, energy, food and health care, the primary elements in today's inflation. It called for reducing unemployment and rebuilding the American economy with a comprehensive reindustrialization program and effective employment and training programs. It called for restoring consumer buying power with a fair tax system to help middle- and low-income wage earners and with basic increase support maintained and improved for the unemployed, the poor, and the elderly.

The program is needed now.

This concludes my statement. If you have any questions, I would be happy to try to answer them.

Mr. LUKEN. The Federal Reserve is now concentrating on this monetarist policy on controlling the money supply rather than controlling the interest rate targets. Is this an effective way to combat inflation? Do you have a comment on that?

Mr. SHEEHAN. I agree with you, as you said when the other gentleman testified, that this is really fueling inflation. As long as this continues, inflation is going to stay at this all-time high level. If that happens, there are going to be more layoffs, business failures, there will be more bankruptcies, economic disaster throughout the country.

Mr. LUKEN. Who has an interest, an economic interest, in maintaining high interest rates?

Mr. SHEEHAN. I suspect——

Mr. LUKEN. That is not very often discussed. As we examine the questions here today and as we survey the business community in Cincinnati, and in the country, everyone complains about high interest rates. Is there a sector of the economy that benefits from high interest rates?

Mr. SHEEHAN. Well, I am sure that many people are getting rich off of the high cost of money today. I thnk this is evidenced in how the money supply distribution is made in this Nation. Each year you see that more and more of the Nation's wealth is controlled by fewer and fewer of the Nation's people. And you can extend that to the world. More and more of the world's wealth is being controlled by fewer and fewer of the world's people.

Now, there obviously are some people benefiting very handsomely from this. But it is not the people I represent nor the people that are represented by small business or the people represented by farming.

Mr. LUKEN. But even the banks have not been doing so well, if you look at their profit statements.

Mr. SHEEHAN. I didn't direct my remarks to the banks. But I think there are other institutions besides the banks that are in the money exchange business, other individuals.

Mr. LUKEN. Do you feel that the President and the Congress should be involved more in the operations of the Federal Reserve?

Mr. SHEEHAN. Well, the Fed controls the money supply. I don't know under our present system of Government who else controls it. I have been of the opinion that the Federal Reserve was operating consistently with Mr. Reagan's idea of economic improvement. Now, just recently——

Mr. LUKEN. Well, of course Mr. Volcker, as is pointed out, was appointed by Mr. Carter.

Mr. SHEEHAN. Well, each President has maintained after a few months in office they have had no control over the Federal Reserve. And even Mr. Reagan has offered criticisms of the Federal Reserve in the past few months. But it would seem to me everything I hear coming out of the Executive Office is consistent with what the Federal Reserve is doing.

Mr. LUKEN. Well, it certainly is not unanimous in the public perception whether the Federal Reserve is following the policies of the administration.

Mr. SHEEHAN. You say it is not unanimous.

Mr. LUKEN. I don't think the public perception is unanimous. Frankly, in talking to people in Washington and to the people in the Congress, I think it is generally recognized that the policies of the Fed coincide with the policies of the administration. However, that is different from saying the administration controls those policies. They happen to coincide. And Mr. Volcker may or may not be taking his cue from the administration. They just happen to agree; and, they could disagree at any time in the future.

I guess in the long term that is the question: Whether the President and the Congress should be more involved in those decisions of the Fed on these very vital matters—whether their views should be considered.

Mr. SHEEHAN. Well, I have long held that elected representatives ought to be more involved in those decisions than they have been. This has not come to pass. And the Federal Reserve has remained rather independent and detached from this process.

Mr. LUKEN. And we may find Mr. Reagan agreeing with you sometime next year, depending upon how things go.

Well, thank you very much.

Mr. SHEEHAN. I appreciate you allowing me to come on early. Thank you.

Mr. LUKEN. All right.

Next we have a panel of homebuilders, developers, and suppliers.

Mr. Robert Jay Buchert, Mr. Hall Clarke, Mr. Chester Roberts, and Mr. George McDonald.

PANEL CONSISTING OF ROBERT JAY BUCHERT, HALL CLARKE, CHESTER W. ROBERTS, AND GEORGE McDONALD

TESTIMONY OF ROBERT JAY BUCHERT, PRESIDENT, AMERICAN HERITAGE CONSTRUCTION & DEVELOPMENT CO., CINCINNATI, OHIO

Mr. BUCHERT. Thank you very much, Mr. Chairman.

My name is Robert J. Buchert. I am president and proprietor of American Heritage Construction & Development Corp., whose business address is 5161 Delhi Pike, Cincinnati, Ohio.

It is a pleasure to be here today to assist in documenting and assessing the damage which excessively high interest rates have inflicted upon small business in this area.

While high interest rates have been, for almost 24 months, a major problem and have now reached the point of being the No. 1 overwhelming problem, we must not overlook the fact that meeting massive Government regulation has compounded the problem even further.

Between 1976 and 1979 my building company grew from 5 to 20 employees, from $2 million to $5 million in sales volume.

Through this period, our price range for a new home ran from $34,900 to $64,900, with an average price of $49,000 and an average interest rate of 8.5 percent. With 20 percent down, a fixed-rate mortgage could be obtained for a period of 30 years with a payment of $285 per month. Today that same average house is $74,900. It has increased $25,000 in less than 24 months.

It requires $4,000 more in down payment. It carries a payment of $1,020 per month, which is fixed for a period of only 3 years, not to mention taxes, insurance, utilities, and upkeep.

I suggest that if we follow the same economic course over the next 3 years we have followed over the past 3, that the over 1 million couples that have purchased a new or used home this year, with a 3-year, renegotiable mortgage, will be facing a payment of $2,500 to $3,000 per month in 1984 when renegotiation time comes.

How have high interest rates affected my business? Well, they about have me out of business.

First of all, we are not speculative builders. We sell from model homes and obtain firm contracts prior to starting construction. We only employ management and sales staff and construction supervisors.

The building construction is done by some 45 separate subcontractors and suppliers.

Through 1980 and 1981, 14 of our employees have been placed on unemployment. It has been an even mix of management, sales, and construction supervisors that have lost their jobs. Their average age is 32, average dependents is three, their average length of time in our industry was 10 years, which was most of their adult life.

Of the 45 subcontractors and suppliers, about 10 are out of business and the remaining are down to the principal of the company and in some cases a few key employees.

High interest rates have devastated most of these people.

My company lost $100,000 in 1980 and will lose that much or more this year. Obviously we cannot sustain losses like this and remain in business.

I submit to you that small business is about to go out of business. And if it does, this country will go from near disaster into complete disaster.

We no longer have the luxury of time. Time has run out. It is no longer a political game. It is a bombshell. Interest rates must come down.

And if the rates do not recede in the last quarter of this year? Congress will need not worry about the renegotiable rates putting mortgage payments at $2,500 in 1984 costing them their jobs; they will lose their job and their future along with small business in 1982.

Obviously it behooves both of us to work together to solve the problem of high interest rates now. It will take a coalition of Democrats and Republicans, both Houses and the administration. It will take working together, not pointing a finger at the past or present administration; not pointing a finger at liberal or conservative Congressmen or Senators.

In order to work together to solve the problems of high interest rates, Congress must be willing to understand and accept the causes of high interest rates.

All of the indicators show that interest rates should be coming down; slower money supply growth, lower taxes, a slimmer budget, less inflation, and reduced regulation.

But the rates have not dropped.

The problem is simply this: The people in the financial markets do not believe Government leaders or have faith in Government leaders.

And why don't they?

Originally, the past administration projected a 1981 balanced budget. This time last year the Congress and Senate projected a $27 billion deficit. The present administration took over and said the truth was $55 billion. Then Congress upped it to $58 billion. And now the reality is $60 billion.

Government leaders have to grasp the fact that we must get serious about cutting the increase in Federal spending.

We must make the cuts necessary to balance the Federal budget. Those in the financial community will not loan their money at 10 or 12 percent when there is a possibility they can get 19 from the Federal Government to fund their debt next year.

The biggest tax and spending cuts in history were recently approved by the House and Senate. But before those cuts could take place in the first quarter of this month, bills have already been introduced to reinstate some of the spending. Letters were sent to those that opposed cuts and some who did not, not to fear that there would be ample time during appropriations to reinstate the spending.

How can you expect to gain the respect and confidence of the financial community and convince them that massive Federal borrowing won't take place next year when you have Members who cannot live with a program passed by the majority for 30 days?

Trust is essential to bring interest rates down.

It is obvious to everyone in this country that Congress is concerned about the effect massive cuts in Federal spending programs will have on the 1982 congressional election.

Congress must act and act convincingly. Congress should not fear in acting in the best interests of this country.

Everyone understands basic economics. When there isn't any left, no one gets any.

For the first time in 20 years the majority of the people agree that Government is too big, spends too much and causes high interest rates.

It is not that the American people have lost compassion and understanding. It is simply this.

It is hard to expect a young couple who has worked hard, saved their money, and cannot afford the privilege of home ownership afforded their parents, grandparents and in some cases even their great-grandparents, to have compassion for someone who is not going to get an increase in their free housing subsidy.

It is hard for a construction laborer who has been cut back to 20 hours per week or lost his job and has a hard time putting food on the table to have compassion for someone who is going to lose 50 calories a day in their free lunch program.

How can a sales or production manager who was not afforded the opportunity to go to college or worked his way through college have compassion for a student who can no longer get a 5½-percent student loan and invest it in money market funds at 17½ percent?

How can you expect a real estate salesman who has for 2 years lost 65 percent of his normal income to have compassion for a retired person who just received a 14½-percent increase in social security but now there is talk that their next 14½ percent might be put off 90 days?

How can anyone, not just in our industry but anywhere, who has not had a pay increase since 1979 have compassion for a Federal employee who might face a small percentage decrease in his guaranteed semiannual increase?

How can a small businessman who is about to lose his business get upset because his community lost its CETA funding and the neighbor kid won't get $7 an hour to cut weeds next summer? Or because community development funds have been cut off and the local officials won't be able to buy a 35-acre farm for a nature preserve to go along with the township and county park already in the community?

Or that the senior citizens won't be able to put an addition on the half-million-dollar center we built them the year before last?

Hasn't the air traffic controllers walkout proved once and for all that Government agencies are grossly overstaffed and a 50-percent cut wouldn't hurt services at all?

Mr. LUKEN. You are not saying that after the walkout of the air traffic controllers the airlines are operating as they previously have.

Mr. BUCHERT. I flew to Dallas, Tex., I have flown to New Orleans, to Boston, and Monday I will fly to Washington and hope to see you again, and it has not affected my ability to travel.

The American people will not be upset with massive cuts in increases in Federal spending in areas of a Government system they know is already bloated. What they will not tolerate is the deterioration and loss of their income, savings, investments, and small businesses which in most cases took a lifetime to build.

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To be successful in bringing the interest rates down immediately to help small business you must do the following:

First, support consistently and unequivocally a course that will balance the Federal budget. Be vocal in your support. Don't back off at the slightest bit of pressure. A reduction in the deficit is essential.

Second, make a conscientious effort to see that the support for a balanced budget by the majority in Congress is expressed in the media. Don't let the continual voice of a few from out of the past who are bent on self preservation or in some cases self destruction send the signals to the financial community.

Third, pressure from the Congress should be put on the Federal Reserve Board to remove one more of the three remaining artificial points placed on the discount rate to curb inflation. This step should only be taken in conjunction with steps one and two, if we truly want to be successful in helping small businesses and this Nation in the long term.

Immediate pressure must also be applied to convince the Federal Reserve Board to request large banks to place a self-imposed moratorium on huge loans that require hundreds of millions of dollars for corporate mergers and acquisitions which add nothing to the gross national product.

Such a moratorium took place in the 1973–74 recessionary period and had positive effects.

In conclusion, my company name is not Build-A-Thon, Design-A-Tec. It is American Heritage. This is because it is my belief that it is the heritage left us by our forefathers that afford the opportunities we have today.

In 1620, 200 people landed at Plymouth Rock with a dream, a dream of religious and economic freedom. Now 156 years later a revolution started by a group of small businessmen fulfilled that dream. It was their faith, perseverance, and determination that made this Nation possible.

With the economic conditions of the past 24 months small businesses should be out of business today. It has been the small businessman's faith, perseverance, and determination that holds him in business today.

He has been willing to make the hard, painful choices of dismissing 14 employees, cutting the salaries of the remaining 6, cutting back on phones, office supplies, light, heat, water, equipment, and cutting his standard of living, cuts he considers being merely responsible. And this is what he asks of you.

Thank you.

Mr. LUKEN. That is a tremendous statement.

I have a couple of questions.

You emphasize supporting policies that balance the budget. But I take it from your overall statement that there is only one policy that you concede balances the budget and this is cutting spending.

Congress has just gone through the experience of substantially cutting spending.

Now, you have suggested rather darkly that that is not going to happen. I don't know that I agree with that. I don't think there is going to be anything in these appropriation bills that is not in that budget. There may be some plans on the part of some people. But I

think the appropriations bills are going to be consistent with the budget.

So we cut—and when I say "we" I mean the Congress collectively and the President—cut spending for the 1982 fiscal year about $37 billion. We also cut the taxes maybe a few billion more. The result is that the administration came back to us and said that the projected deficit is going to be greater and we must cut the budget even more.

Now, I don't know whether you have any comment on that.

I voted for the tax cut. I am not reneging on that vote. But neither am I fully convinced that that vote for the tax cut did not at least for 1982 have the effect of increasing the deficit.

I don't know whether you have any comment on that.

Mr. BUCHERT. We make paychecks out the first of the month. For my average employee, it amounted to about 5 bucks. I have six employees left. All together we robbed you of $30.

Mr. LUKEN. The tax cuts for next year are in the neighborhood of $50 billion.

Mr. BUCHERT. That is provided people make money. I have had years in my company where my company has paid in excess of $150,000, even with shelters, in Federal income taxes. I personally paid in excess of $50,000. Presently, for the last couple of years, I have not paid a nickel. In fact, you are sending me checks back. You cannot continue like that. I think you have to get down to basic economics. When there isn't any left, nobody is going to get any.

So we have to look seriously and figure out a way to balance that budget.

Mr. LUKEN. I agree. That is what we have to talk about; how we are going to do it. But the policies that we are now following, at least initially, do not indicate that we are moving in that direction.

The Congress passed the package, without any variation, that the President placed before it. That does not mean that is the end of it, of course; and the President did not say this is the end. He did say, through Mr. Stockman and himself, that further cuts are going to be necessary next year. He has come back now and said that further cuts are going to be necessary now, which is a little change from a couple of months ago.

You are saying, I assume, that the Congress should do that. And that is certainly a reasonable proposition. I am not arguing with that. It is at least an arguable proposition, and one that very well may be entertained and agreed upon.

But I do have a question as to whether or not our total policies of tax cuts are leading us in the right direction. Supply siders argued tax cuts were going to produce increased revenue, produce growth, to the Federal coffers, therefore lower deficits, and therefore inflation would go down. But since we passed the tax cut there seems to be a great deal of doubt as to whether all that is going to work.

You haven't said anything one way or the other about it, and I don't know if you have any comment about the tax cuts. I understand fully what you are saying about the spending.

Mr. BUCHERT. On tax cuts, first, we are into our third day. I sent you 30 bucks. I think it is a little early for all of us to tell. I think

it is going to take time to tell. I don't think we can automatically say the program is not working.

What I am saying is that it behooves all of us to work together or we will all be out of work. It doesn't affect just small business.

We don't know yet. We have to look at the tax program and hope it works. I think you have to give it a little bit more time. If it is not working, you have to change course.

It is not a matter of pointing a finger at the administration, the Congress. It behooves all of us to work together.

I really believe it is a bombshell. It is devastating if another 2,500 automobile dealers go out of business. I will guarantee you I will go out of business. I am not saying I am bankrupt. But I am going out of business in 1982 if conditions don't change. I have no reason to keep my retained earnings in that company invested the way I have them invested, which is in employees, and trying to positively be a producer.

Mr. LUKEN. All right. Well, that is very clear and cogent testimony. I appreciate your answers.

Next we will hear from Mr. Roberts.

TESTIMONY OF CHESTER W. ROBERTS, PRESIDENT, CHESTER W. ROBERTS CO., MAINVILLE, OHIO

Mr. ROBERTS. Mr. Chairman, I am Chester Roberts, a homebuilder.

As a small businessman engaged in the business of building homes, I welcome the opportunity to testify before this hearing regarding the excessively high interest rates which have brought my business to a complete standstill.

I have worked hard all my life producing products and services, thus being a tax producer. Now, however, as a result of these high interest rates, I shall soon become a tax user. I am out of a job, to state it bluntly.

Paul Volcker and the Federal money meddlers are directly responsible for the high interest rates which are supposed to bring down the rate of inflation. However, as we all know, it has worked just the opposite. The high interest in itself is inflationary, being the single most expensive cost in housing.

The cost of financing is borne by the land developer, materials suppliers, and homebuilders alike. It is then reflected in the price of the home and passed on to the buyer. In most cases the would-be buyer simply cannot qualify for a high interest rate loan, even though he has a down payment, a good job, and good credit. And herein lies the problem.

Another thing. The past performance of the Federal Reserve money meddlers during the past 2 years has created another problem which is even more devastating.

With the interest rates going up and staying up, the public has become distrustful, afraid, and turned off because it knows it is being had. Therefore, even though there is a real demand for housing, the buyer is simply playing a waiting game and refuses to participate in the shell game manipulation by the Federal Reserve.

Lenders talk mostly of short term 3-year rollover loans and beyond that it is a shot in the dark as to what the interest rates will be.

Logically then the buyer is saying if the lenders will not commit themselves, why should they. The buyer feels he is at the control and mercy of the lender and could be wiped out financially 3 years later.

Last week I talked to the manager of a very prominent real estate firm and he told me, "I placed 20 ads in the Sunday Inquirer advertising special interest rates and our office received three phone calls, and one turned out to be productive."

People are turned off because they no longer feel they can predict or control the cost of interest or their purchase. Therefore, they are just simply not buying.

High interest rates are hurting millions of American families, industry, business. Homes are not being built. Potential buyers no longer can afford to buy at exorbitant rates. Automobiles and other consumer needs are going unsold for the same reason. People are losing jobs as business sags. Savings are vanishing. The Government is losing tax revenues as more jobs disappear and profits dip. Personal and business bankruptcies are at an all-time high.

If interest rates would come down to a respectable level and stay down, then the confidence of buyers would again be restored and affordable housing would be realized by millions of American families.

As homebuilders we have the ability and determination to serve the housing needs of the country, if the Federal Reserve would desist from dealing a stacked deck.

Thank you very much.

Mr. LUKEN. Thank you very much, Mr. Roberts.

Next we will hear from George McDonald.

TESTIMONY OF GEORGE W. McDONALD, EXECUTIVE VICE PRESIDENT, CINCINNATI BUILDERS SUPPLY CO., CINCINNATI, OHIO

Mr. MCDONALD. Congressman, I appreciate the opportunity to be able to express my opinions to you regarding our phase of the building industry and how high interest rates are affecting our business operation.

We have been in business over 60 years and I have been associated with the company over 34 years in sales and management, and for the past few years as one of the owners. We supply hard building material such as brick, fireplaces, and other masonry-related items to home, apartment, and condominium builders as well as furnishing these materials on commercial and institutional buildings. Our sales on residential construction such as homes, apartments, and condominiums have, in the past, accounted for 65 to 70 percent of our volume.

Our fiscal year ends March 31. In our fiscal year 1979–80, we were about 10 percent over our sales volume of our 1978–79 fiscal year. However, in our fiscal year 1980–81 we were down 25 to 30 percent from the previous year. And through August of this year we are down 20 percent when compared to a like period of 1980. The above decreases far exceed the loss of sales we experienced in the 1974–75 recession and without a doubt are the worst business conditions in my time with the company; in fact, worse than the

years of 1937-41, during which time I was also working in the construction industry.

It has been necessary for us to lay off employees this past year. Quite frankly, we know we are facing a long, tough winter and consequently must lay off additional employees or, quite frankly, lock up the business. Employees still on our payroll, including officers and owners, as of November 1, 1981, will be working for reduced wages amounting to less than their earnings during 1978. Instead of paying taxes on wages, our laid-off loyal employees will be drawing unemployment benefits that force the Government to either increase taxes or borrow additional money which drives up the interest rates.

One of the most discouraging factors of the construction business, in my opinion, is the 4- to 5-year cycle we have experienced for the past 25 to 30 years. When interest rates are at a minimum, business conditions, as a rule, are good, and it is necessary to expand our operation to meet the needs of our customers. New employees must be trained to accomplish our needs and after a training period of 2-3 years and you feel you have a well rounded operation, invariably someone in Washington is of the opinion it is time to turn off the faucet. Consequently, the interest rates go up and all construction is reduced and it is necessary to lay off employees who are just beginning to get to the point where they have the skill and the knowledge of their job that would permit the employer to reap a few benefits to offset the expense of training this person, and likewise, would qualify the employee for a higher wage. But this is not to be—they must be laid off due to the same old story.

It is my opinion Government should not subsidize any product nor should they control interest rates. If this could be accomplished, the law of supply and demand would be conducive to more stable business conditions with few or no cyclical changes.

All of us at the Cincinnati Builders Supply Co. recognize and appreciate your past accomplishments and sincerely hope you are fully aware of the condition of our industry and that you will expend every effort to obtain immediate assistance for all of us.

I would be happy to go into further detail relative to some of our major suppliers around the country who are experiencing the same, if not worse, conditions. If you should need this information, please let me know.

I want to thank you for the opportunity to be here.

There are a few other comments I would like to make.

I feel like Mr. Buchert and everybody else. We have to balance that Federal budget and reduce Government spending. I personally feel we are going to have to come up with other methods of financing home mortgages, such as pension funds. There should be some support along this line. Tax-exempt revenue bonds for single and multiple family housing are another example. Even restructuring our Federal Reserve Board to get other people on it besides bankers.

That is about the limit of my suggestions.

Mr. LUKEN. Let me ask you this.

Some very important people in the Congress who sponsored the tax cut are now having second thoughts. Kent Hance is the gentleman whose name is attached to the tax bill. He is a Democrat from

Texas. He recently proposed, along with a number of other people, that the individual tax cut be postponed for 90 days; that is for the year coming up. And even some responsible national organizations, like the realtors—and this position is not unanimous on the part of the realtors when I say that—many agree with Mr. Hance's proposal. We don't know whether that opinion actually represents the majority thinking. But some responsible people have suggested this.

Would you have any comment on that?

I am just trying to get your feeling about tax cuts. You certainly come through loud and clear on the budget cuts. But I would like to know whether we should consider the tax cuts as possibly also contributing to the deficit.

Mr. McDONALD. I would be in favor of rescinding the tax cuts for another year if it will bring the prime rate down, bring our interest rates down. Absolutely.

Mr. LUKEN. All right. Thank you. I appreciate your entire testimony.

Next we will hear from Mr. Hall Clarke.

TESTIMONY OF HALL CLARKE, ASSOCIATE, HENDERSON & BODWELL, MASON, OHIO

Mr. CLARKE. Gentlemen, my name is Hall Clarke. I am an associate of the firm of Henderson & Bodwell, a consulting civil engineering firm, and have been given responsibility for the operation of the firm's Cincinnati branch office.

Henderson & Bodwell is a New York partnership which is continuing a consulting engineering business originated in 1947. Our firm originally was one which specialized in waste water collection and treatment and in purification and distribution of water.

Throughout the years, at the request of its clients, the main thrust turned to the planning and design of land development for housing. With that we included not only the design of streets and lots but also of the utilities which service them and the amenities which are required to make the development more livable.

My own experience includes private practice such as Henderson & Bodwell now provides, as well as staff positions for national homebuilding firms, Levitt & Sons and the Larwin Group.

I have, as well, served as municipal engineer and consultant to planning and zoning boards.

I have therefore been very closely associated throughout my professional career with the homebuilding industry and have, for at least half of that time, been responsible for operation of a profitable business.

I respectfully suggest, gentlemen, that you recognize that the homebuilding industry is one of the major influences in the American economy. I feel that it at least ranks equally with the automobile industry, aircraft industry, and the heavy construction industry as being the generator of employment and production in the industries as basic as the sand and gravel industry and the lumbering industry, and as esoteric as the home alarm and protection industry.

I strongly believe that the building industry, which is directly responsible for a very large percentage of many paychecks, is one that can overcome a good deal of adversity.

The building industry will have to revise its concepts of affordable housing in order to meet the very obvious demand for homeownership, since the largest proportion of the American public is neither able nor willing to carry mortgages of more than $25,000 or $30,000 at the current interest rates. These same people are not prosperous enough to put more than 5 or 10 percent of that amount down on a property. They all would like to have the rights and benefits of homeownership.

However, because the cycle from acquisition of land, preparation of plans and estimates to determine feasibilities, the conforming with all amendments to zoning, subdivision, and design requirements of approving agencies, the physical construction of the improvements, the acquisition permits, the construction of housing and the finding of buyers to the final consummation of the sale normally spans a 2-year period, the imposition by the financial community of variables which the builder or developer or engineer or contractor cannot control simply means that the businesslike builders will not venture. That is because the cash investment of a builder or developer is put on the line very early in the project and projections of sales rates have to be predicated on the market conditions then existing.

Henderson & Bodwell opened the branch office in Cincinnati, March 15, 1977, in order to service one developer, the Landen Farm Co. Since that time our client list has expanded so that it includes builders, developers, and a very small amount of governmental bodies, all equally good risks.

In 1977, we prepared development plans for approximately 300 lots. In 1978, we prepared plans for 400 lots and brought our staff to the size which would maintain that level of production. In 1979, we prepared plans for some 400 lots. Going into 1980, we had high hopes of repeating the previous year and found that the developers were not turning their lots over to builders as rapidly as they had forecast and our production of plans for development of land for single family residential units decreased to approximately 200 units.

In order to maintain the viability of the office, we were forced to reduce our staff by roughly 20 percent.

We attempted to change the thrust of our marketing efforts from single family home development and design to office and commercial development and to governmental design, particularly the water and sewer fields.

During 1980 and 1981, we have so far provided governmental agencies with plans and specifications for projects and have been awarded the step 2 design contract of an interceptor sewer, the funding of which is still uncertain. Additionally, we have successfully acquired two commercial and industrial design contracts.

In 1977 and 1978, our invoices were paid promptly enough so that at any particular time our invoices 30 days or more old represented 1 month's worth of invoicing. Through 1979, this grew to 2 months. In 1979, we felt that by renegotiating our contracts and agreeing with our clients that accounts older than 30 days

would bear interest at the rate of 1½ percent per month or 18 percent per year, we would be able to hold the line at the 2-month number. Even so, through 1980 and 1981, our accounts receivable have increased to represent a companywide average of 5 months' worth of invoicing, and in the Cincinnati area, 7 months' worth of invoicing.

This is a drain on our company finances and our nervous systems.

However, we find that when the prime rate is at 17 percent or above, we are effectively loaning our money at a lower rate than our clients can get from the banks and we are conservative enough to feel that we do not belong in the banking business.

I have been very much involved in the billing and collection field this year and part of last year and have been given many reasons for delayed payments, of which the foregoing is only one.

Our development clients were able in 1977, 1978, and early 1979 to turn developed lots over to builders as soon as, if not before, they were complete. The builders were in the position of having their houses sold well before they were complete and in fact at times were required to postpone closings because construction could not keep pace with demand.

While the size of the average family has decreased, the number of households, according to the September 1981 issue of Planning published by the American Planning Association, increased more than twice as fast as the population. This is represented to be due to the increase in single person families, smaller families, and a growing number of senior citizens.

Conversations with builders have resulted in my having a very strong feeling that in this particular market there is a large pent-up demand for housing but that the uncertainty about the cost of money, the peculiar debt instruments now coming into use, and most particularly the high monthly payments required, are among the largest factors for the curtailment in sales.

I am acquainted with most of my competition and have talked with many of the principals of the firms and find that Henderson & Bodwell is not alone in its problems and in fact is much better off than those who have had to either close their doors, reduce their workweek or their staff or, in at least one case, declare bankruptcy.

Henderson & Bodwell is fortunate in that the partnership agreements require that a relatively large amount of cash be kept available for emergencies. This cash is currently in a daily accumulation fund. I was given a prospectus from that fund showing the proportion of the fund in various industries; 16½ percent of that fund on the 31st of December 1980, was in the banking industry and represented funds due from January 5, 1981, through February 26 to 27, 1981. Interest cited on these various instruments ranged from a low of 14 percent to a high of 21 percent and represented a market value on the 31st of December of $388 million.

It would appear to me that banks loaning to and borrowing from other banks are extremely well situated to influence the cost of money, and their stockholders would be poorly served if the cost of money was not increased.

It would appear to me also that the prime rate, which I have heard described as being that rate which is charged the most favored customers of the banks, is also very subject to manipulation by the banking industry.

I am also aware that the incursion of the Federal Government to the money markets, borrowing to pay interest on borrowing and borrowing to repay previous borrowing, and borrowing in anticipation of income, cannot help but to increase the cost of money.

That last item, gentlemen, is one that you have much more control of than I. I can speak only for myself based on my knowledge of our firm and its condition, and I know that if our business does not either change to an area or field in which we can expect payment within 30 days of invoicing or if the economic conditions attendant on the housing industry do not improve drastically, we will be faced with an extreme reduction in staff. A reduction in staff will have deleterious effects on the economic condition of the people who are cut and on the unemployment insurance fund and on the State and national income since those people will no longer be able to pay their taxes.

We will naturally attempt as long as it is economically feasible to keep everybody employed, but we realize that people who are having a problem paying their bills with 5 days' pay are going to be hard pressed when the paycheck is any smaller.

I am not advocating stagnation. The OPA was a noble experiment that acted well in the short term but was and is not something which the American public could accept as a permanent solution.

I relate very strongly to what happens to me. I can remember that when my father was paying 5 percent interest on a mortgage, I was getting 3 percent on a savings account that increased by pennies a week. When I bought my first house under the GI bill, I paid 4½-percent interest which was admittedly below the market of 5 percent. It was 1 percent above the passbook rate. When I moved and bought a different house, passbook interest was at something between 4½ percent and 5 percent, the mortgage was 7 percent.

Today, when mortgage rates are being quoted from 12 percent to 20 percent, my passbook rate is at 5¼ percent.

It would appear to me very obvious that the difference is getting out of hand.

I do not like to suggest governmental regulation of any industry, but I do feel that the banking industry has not helped the good and welfare of Hall Clarke and the people who work with him.

I thank you very much for your time and patience in listening to me.

Mr. LUKEN. Thank you very much, Mr. Clarke. That is very clear and complete testimony.

We thank this panel for making a very broad presentation of especially what is happening in the building business, at least the homebuilding business, in this area.

Your testimony will be received into the records of the committee and will be very helpful to us in our deliberations.

Thank you very much.

Mr. BUCHERT. Thank you very much for this opportunity.

Mr. LUKEN. At this time we will hear from Mr. Walter Paul.

TESTIMONY OF WALTER PAUL, VICE PRESIDENT, QUEEN CITY BARREL CO., CINCINNATI, OHIO

Mr. PAUL. Mr. Chairman, I was president of the Queen City Barrel Co. Because of the high interest rates and recession they gave me the boot. I am now the vice president.

I apologize for not having a written statement. I didn't get your letter until yesterday afternoon.

I want to say that the Queen City Barrel Co. has been in business in Cincinnati since 1926. So it has been in business for a long time.

As you and I have talked over, it has always been a recession-proof business. We did not make money in the depression, but we did not lose money in the depression.

I began working at Queen City Barrel when I was 14 years old.

As I testified a year ago April, to the Small Business Committee, chaired by New York Congressman LaFalce, I called to the attention of the committee that high interest rates were going to create a great problem and a recession for small business.

Although you were very gracious to me, I felt the chairman certainly did not seem to be too interested in my statement.

If you remember, at the time I called for a moratorium on the nonproductive capital expenditures that the Government expected small business to come up with as far as OSHA, EPA, et cetera, and that I felt that until those interest rates come down, there be a moratorium by the Government on those items.

I spoke in April 1980. Our fiscal year ended April 30, 1980. That year we produced 720,000 reconditioned drums. This year, April 30, 1981, we produced 620,000 drums, and we lost $170,000.

In addition, we spent, because we had to, for nonproductive capital expenditures, $350,000 and have another $40,000 to spend; this despite the fact that this year, in the first 4 months of our fiscal year, we have already lost $80,000.

We are heading for about a 580,000-drum year, from 720,000 which is our norm.

There is little doubt that the marketing area has been greatly affected by the recession, and probably because of our proximity to Detroit. We find in our industry that when you get west of the Mississippi River, most of the people in our industry have never heard of a recession. The recession in our industry is primarily in the States of Illinois, Indiana, Kentucky, Ohio, Pennsylvania, New Jersey, et cetera.

I want to say that last year when interest rates did drop, and I think prime went all the way down to 12 percent, during that period business picked up about 15 percent. So there is a direct correlation between interest rates and the level of business, at least as far as I see it in our industry.

However, I think interest rates reflect the demand for and the supply of money. And I think they are where they should be based upon the deficit of our Government.

The only alternative is to print more money, which is inflationary.

Mr. LUKEN. Are they where they should be in relation to the inflation rate?

Mr. PAUL. They are where they should be also in relation to the inflation rate, I feel.

Mr. LUKEN. The inflation rate has been hovering around 9, 10 percent; hasn't it?

Mr. PAUL. But there is no doubt——

Mr. LUKEN. And interest rates are well above that.

Mr. PAUL. There is no doubt that until you balance the Federal deficit, there is no way you are going to get rid of inflation and lowering the interest unless you print more money, which means more inflation. I know it is like a dog chasing his tail. I am well aware that the high interest rates are only adding to the deficit. But I thought the young man who spoke as the first speaker for the homebuilders could not express it better. He certainly expressed it a lot better than I could.

I think the Congress must bite the bullet. I am willing to suffer.

Mr. LUKEN. I have to take one little exception. Mr. Buchert said it beautifully. He stated at least two options that the President doesn't want to face, either. He referred to the social security recipients who receive 14 percent.

Mr. PAUL. He said he didn't feel sorry for them because he had worse situations. That is all he was saying.

Mr. LUKEN. He had beautiful rhetoric. I thought it was great. But he lumped that with all the other spending things. That is a little item of spending.

I am not arguing the point of whether or not what Mr. Buchert was advocating was right. But I don't think we necessarily advance the cause.

One thing he did say, and he said it beautifully also, is this: It is not going to do any good just to point the finger. The debate tends to degenerate into saying Congress has got to do this and Congress has to do that. If we choose up sides and say Congress has to be doing these things and Congress is sitting there knowing that the President in many cases is also not in favor of these particular cuts——

Mr. PAUL. That doesn't make the President necessarily correct. As I discussed with you at one time——

Mr. LUKEN. If I could finish just this one point. If we cut the COLA for social security, if that were cut by several points, the Federal deficit would be helped considerably.

Mr. PAUL. I read in the paper this morning that the defense budget was $180 billion, and I don't think if you took another $20 billion out of that it would be the end of the world. It seems nobody wants to give up anything. If you expect people to suffer like we are suffering in small business—and I am willing to suffer, to lose money, I am willing to make cutbacks in efficiencies and take pay reductions. But everybody has to suffer.

If we don't have a strong economy, it is not going to help us to have all the missiles to defend ourselves, because we are going to have internal revolution. We have to be strong inside and outside. I am a hawk. I am for the defense budget. But if it has to be cut back $20 billion out of $180 billion to help you balance the budget, and cut back on the deficits, I feel it has to be done.

There are some tough choices to be made here. Everybody has to give something. And it is not easy.

Mr. LUKEN. All right. I think you have stated it well and concisely, repeated many of the sentiments that Mr. Buchert stated, and they were applauded, and appropriately so, because they were very well stated, as you indicated. Certainly there are strong arguments that you are making and forceful arguments that you have made. Maybe they will take effect. We will do what we can to convey the message and try to carry it out.

Mr. PAUL. I appreciate your attention.

Mr. LUKEN. I want to recognize Walter Paul has not only been a strength here in Cincinnati, involved in small business associations, but particularly as an individual he has been willing to spend the time to tell the people who are making the laws what is really going on from the vantagepoint of somebody who has been in the field for a long time.

So thank you, Mr. Paul, again.

We will now call upon the representatives of the savings and loan associations, Mr. Emden and Mr. Reusing.

PANEL CONSISTING OF NARVIN EMDEN AND JOHN R. REUSING

TESTIMONY OF NARVIN EMDEN, PRESIDENT, FOUNDATION SAVINGS AND LOAN CO., CINCINNATI, OHIO

Mr. EMDEN. Mr. Chairman, we very much appreciate this opportunity to represent the small savings and loan companies in this country. It is a voice that is not heard very often, yet it represents a large majority of the savings and loans in this city, in this State, and in our Nation.

We are concerned that the small savings and loan does not have an adequate voice in either State or Federal legislative process.

I am Narvin Emden, president of the Foundation Savings & Loan Co., an $18 million federally insured mutual savings and loan located in downtown Cincinnati. Our company will be 100 years old in 1982. I have been its managing officer since 1949.

We have grown by providing a very personal service to our community. Our slogan, "Our President Makes House Calls," indicates how we serve the public.

I have enjoyed my work and I have received particular pleasure in helping people finance their homes. I am now serving on the local, State, and national league committees for small savings and loans. I am also serving on the advisory committee of the superintendent of building and loan associations of the State of Ohio. I am a past president of the Savings & Loan League of Southwestern Ohio.

As you can see, I am deeply involved with the role of the small savings and loan and I have been for a long time.

When Washington looks at the savings and loan industry, we are concerned that Washington sees the billion dollar California savings and loan as typical. It is not. Over 3,500 of the savings and loans in this country are under $75 million in size. Two hundred and sixty-six savings and loans in Ohio are under $75 million in size. Eighty-eight savings and loans in Hamilton County are under

$50 million in size. The typical savings and loan company is the $50 million company in Ohio or Illinois.

The small savings and loan has been successful for 150 years in helping to supply this country's housing.

Congress has recognized the role of the thrift institutions in providing most of the funds for this country's housing and, consequently, has passed legislation to help savings and loans secure funds at a reasonable rate of interest.

Most of the savings and loans in this country do not want to become banks. They do not want to become security dealers. They do not want to become trust administrators. They just want to continue a very personal relationship with the people they serve and they want to continue to finance most of the housing in this country.

High interest rates and congressional action to deregulate the financial industry at a time when interest rates are at a historic peak are destroying the best housing delivery system the world has ever known.

The small savings and loan has suffered a particularly great burden because it has limited staff and limited resources to continue its work, and every time Congress or a governmental agency moves to deregulate, it is mighty difficult for the small savings and loan to react. Continued deregulation of the financial institutions of this country at the present fast pace will bring about the demise of the small savings and loan.

John R. Reusing, vice president, Cincinnati Federal Savings & Loan Association, will now discuss how high interest rates are affecting his small savings and loan operation and the savings and loan industry.

TESTIMONY OF JOHN R. REUSING, VICE PRESIDENT, CINCINNATI FEDERAL SAVINGS & LOAN ASSOCIATION, CINCINNATI, OHIO

Mr. REUSING. Congressman Luken, I would like to preface my remarks with a statement which might be made by a savings and loan executive to his board of directors. He would tell them that he had good news and bad news, the bad news being that current mortgage interest rates were so high that no one could afford them, much of their savings capital had been withdrawn and placed in money market funds reducing their liquidity to almost nothing, and the savings that was retained was so expensive that their reserves were depleted, in essence they were bankrupt. The good news was that their association was in full compliance with all the rules and regulations mandated by the Federal home loan bank. This scenario may seem a bit exaggerated, but I assure you that it is well within the realm of possibility.

In Ohio we have the fourth largest savings industry in the United States with assets of over $40 billion. Small savings and loans, those under $75 million, comprise 70 percent of the 377 savings and loans in the State and represent 70 percent of the total assets.

I am vice president of a small $19.25 million company, and I would like to illustrate the effects of high interest rates on our particular association as well as other small associations.

Currently, my company is maintaining almost triple the amount of reserves required and triple the amount of liquidity required with 2 percent borrowed money. At the end of September, out of a loan portfolio of $16 million, we had no delinquent interest. In the last 35 years, making millions of dollars in conventional, FHA, and VA loans, we have had a net loss of $1,300. And not one of these loans cost the Federal Government a penny.

As you can see by these statistics, our savings association is operating at what I believe is an optimum level of efficiency, like many other small savings and loans in our area. Yet through no fault of our own, our cost of money has increased 211 basis points in the last year, or we paid 26 percent more interest for essentially the same money.

In contrast, our loan income increased only 4.1 percent because a large majority of our loans are at a fixed rate, many below 9 percent. In order to compensate for this inequity, our liquidity has been our only resource. We have been able to invest in high-yield, short-term instruments such as the overnight deposit at the Federal home loan bank. This income now comprises 25 percent of our gross operating income. Whereas in the past this money was considered a bonus to the association, it is now an absolute necessity.

The general public fails to realize that in order to generate enough income to pay interest on a 2½-year, 16.50-percent money market certificate, a mortgage loan for 25 years must be originated at an interest rate of 20 percent. That still does not cover overhead, taxes, or profit.

In 1980, we charged a mortgage rate as low as 12½ percent. Today rates are at 17½ percent, or translated, a payment increase of 36 percent. Our loan originations are down 51 percent this year, and I think this indicates the lack of funds available and that the potential buyers have reached the end of their economic rope.

The savings consumer is the only one to benefit from these high interest rates, and frankly they could care less if their savings and loan is not able to afford it. As long as they receive their interest checks in the mail, that is their only concern. This role does change when these same savings customers try to sell their house and wonder why no one can afford it.

This past week the Federal Government postponed its T-bill auction until the national debt was extended to over a trillion dollars, and this is the same Government that will, in the next 6 months, be going into the market for another $60 billion.

We in the savings and loan industry do not have the luxury of raising our debt ceiling, but we will be forced to compete or suffer total and irrevocable disintermediation. All of our most popular certificates are based on Government issues and this week we are forced to pay over 15 percent on our 6-month CD's. When will this end?

One final point that I would like to elaborate is that in Ohio the savings and loans are beset with an intangible tax, second to none in the United States, which negates any marginal profit. If my company breaks even this year with no profit to show we will still have to pay over $36,000 in tax which would come directly from our reserves, the same reserves which the State taxes at an even higher rate. I realize that this is a State issue, but I brought it to

your attention to show that our industry is getting hit from every side.

On the national level, savings and loans lost $1.5 billion in the first 6 months, and already in July and August their net worth has decreased over $1 billion.

My family, which has over 100 years' experience in the savings and loan field, is perplexed. My father, with 45 years in the business and one-time vice chairman of the Federal Home Loan Bank Board of the Fifth District says it looks like 1929 again.

I appreciate the opportunity to testify from the perspective of a small savings company. My colleague, Mr. Emden, would like to conclude with suggestions and effects of deregulation on the savings and loan business.

Mr. EMDEN. Thank you, John.

Everyone favors deregulation. A small savings and loan manager has to favor deregulation when he receives Federal Home Loan Bank Bulletin No. 111 before the end of September 1981. The number of Federal Home Loan Bank bulletins that he will receive this year alone exceeds the number he received for the entire 10-year period 1950 to 1960.

Congress had good intentions when it passed H.R. 4986, the Depository Institution Deregulation Act of 1980. This law provided for a gradual phaseout of interest rate regulation as rapidly as economic conditions warrant with due regard to the safety and soundness of depository institutions. Five appointed officials have been designated by Congress to implement H.R. 4986. These five heads of Government agencies form the Depository Institutions Deregulation Committee. Only one member of the committee represents the thrift industry and the housing industry, and his pleas to slow the pace of deregulation go unheeded. We charge that this committee has acted beyond the authority granted it by Congress in speeding up interest rate deregulation to the point where the continued existence of thrift institutions and the housing industry is threatened.

The administration wants the consumer to receive market rates on savings. It believes that savings and loans can afford to do this by using additional powers to earn the rates of interest necessary to pay market rates to savers. It proposes that savings and loans go into commercial lending and finance large developments and generally become banks. There is no way small savings and loans can exercise these powers. In fact, they do not even want them. Why isn't the administration concerned with that large segment of the consumer population that wants to buy or sell a home?

Everyone in Washington knows that inflation is causing the high interest rates. The only long-term solution is to moderate inflation. The short-term solution to bring interest rates down is to slow down the activities of the Depository Institutions Deregulation Committee until inflation has eased a little. This is a disastrous time to deregulate savings rates at a fast pace. A slower pace of deregulation will permit the work of Congress and the administration to take effect.

Congress has given us the all savers certificate.

I want to digress a moment from my notes, because these were written early yesterday morning. Yesterday during the entire day

we had a minor miracle, a remarkable experience. We are a very small savings and loan. We have developed a very close relationship with many of our depositors and our customers. Yet there is nothing we could do to stem the tide of the flow of our funds to money market funds. Even my house calls did not help.

Yesterday, we opened 37 all savers certificate accounts. Most of the money was new money. Most of the new money was from money market funds. So the all savers account did what nothing else could do—it provided a savings incentive by a tax benefit to bring money back to the savings institutions from the money market funds and hopefully into the housing industry.

Mr. LUKEN. Can I ask you a question about that; not just about your experience, but whatever observation you would have? I am looking at this from the standpoint of what kind of arguments we may marshal for an extension in some way of all savers.

You said, "Hopefully into the homebuilding business." Would you comment on that.

Mr. EMDEN. That is covered in the next few sentences, but I will be glad to expand upon it.

Mr. LUKEN. Good.

Mr. EMDEN. We are concerned about how these funds will benefit housing. Can we invest 1-year funds in long-term mortgages even if they are adjustable rate mortages. What happens when these certificates mature.

The Secretary of the Treasury, Mr. Donald Regan, is to judge the effectiveness of the all savers certificates in bringing money to thrifts and to housing. We are concerned that this decision is in the hands of a man dedicated to paying savers market rates at the sacrifice of the thrift and the housing industry.

We are also concerned about how we can get this money into housing when it is a short-term proposition and we have our money invested long-term into housing.

We have not made a decision on what we are going to do with our funds. But we have to keep in mind a year from now if the all savers certificate is not expanded to a longer term, we have to prepare for something that is going to occur at that time.

Mr. REUSING. The other option available, Mr. Luken, is the fact in the next 6 months offering the all savers certificates, if we do not adhere to Government regulations and invest 75 percent of that money into the home market, we will not be able to offer all savers certificates. But at least for 6 months we will, and maybe we will be happy with that.

Mr. LUKEN. You invest 75 percent of the new funds.

Mr. REUSING. That is correct.

Mr. LUKEN. But that merely means you have to show that you have loaned out that amount.

Mr. REUSING. That is correct.

Mr. LUKEN. For a small institution like yours, I presume that is not a complex matter. But in the larger institutions—how is it going to relate or how is it relating to FNMA investments?

Mr. EMDEN. We have people in the industry that indicate they can do no more than go into a year's investment with it. I have always felt as a small savings and loan operator that our contacts, our future business, comes from the people to whom we lend

money to finance homes. I don't like the idea of just setting it aside in FNMA securities. I would like to lend it into the housing market, and I am still trying to figure out a way to do it.

Mr. LUKEN. Well, if a large portion is utilized or invested in FNMA securities, is that going to be helpful?

Mr. EMDEN. Not to the local housing market, no, it is not.

Mr. LUKEN. How much of it do you think will be diverted into that?

Mr. EMDEN. It could be substantial, unless some new thought is presented to help us get into the housing market directly. I am trying.

Mr. LUKEN. Still in many ways the program is at least as good as the industrial revenue bond program.

Mr. EMDEN. Yes.

Mr. LUKEN. I mean as far as there being any kind of giveaway or anything of the sort.

Mr. EMDEN. There is no question that it is and it will bring money into the thrift institutions, the all savers certificate. There is no question that it is drawing funds from the money market funds where there is no chance for it to go into housing.

Mr. LUKEN. Do you have any questions, Mr. Dalton?

Mr. DALTON. What is the rate that you are paying?

Mr. EMDEN. 12.61 through tomorrow.

Mr. REUSING. With some associations open tomorrow also you get anybody that wants to come in at the last minute to get the higher rate. And again that is the first time I know of that a savings and loan has been open on Sunday.

You have people here from the real estate board. Let them answer the question. If you pay your rate plus your intangible tax, plus insurance, we have to get 15.5 percent for mortgages. You people in the real estate business, will that sell your houses? No.

Mr. EMDEN. I have a short conclusion.

The Depository Institutions Deregulation Committee has just done it again. It has speeded deregulation of savings rates by creating a 1½-year wild card certificate for IRA and Keogh accounts. Large financial institutions will literally go for broke to attract these funds. These institutions will set the standard for the industry. Money will be attracted by these accounts. However, what chance will we have to offer housing money at 12 percent to 13 percent? These are the rates that trigger housing activity.

The all savers certificate is a good start to bring down savings interest rates and help the housing market. Congress is acting to bring down interest rates to help the housing market and to improve the level of savings of the country.

The savings incentive provisions of the Economic Recovery Tax Act of 1981 are a good start. Our national 5.6 percent savings rate is much lower than any of the six largest western industrial countries. There must be a savings incentive in this country and the only way appears to be through tax benefits. It is very important for the housing industry and for raising investment capital that the savings incentive that just started this week be continued and expanded in the future.

The small savings and loan has served the country well. We have served the housing industry well. The chairman, in cosponsoring

the All Savers Act, H.R. 3456, stated on June 9, 1981, in the House of Representatives, "The American dream of homeownership must be preserved at all costs." Unless congressional action is taken immediately to slow down the rate of deregulation of financial institutions, and unless savings incentives are continued and expanded, the American dream about which you have spoken, Mr. Luken, will become a nightmare.

Thank you.

Mr. LUKEN. Thank you very much.

There is much further discussion that we might get involved in and we would benefit by it, but we do have several other witnesses who have been waiting. We thank you very much for your testimony. It will be presented to the committee and to the Congress. It will be very helpful.

Mr. EMDEN. We appreciate the opportunity.

Mr. REUSING. Thank you.

Mr. LUKEN. Next we will hear from Mr. McCluskey, president of the Cincinnati Board of Realtors.

Your testimony has been presented in writing. Without objection it will be received into the records of the committee. You may proceed in any way you see fit to make your presentation.

TESTIMONY OF MICHAEL G. McCLUSKEY, PRESIDENT, CINCINNATI BOARD OF REALTORS, ACCOMPANIED BY EUGENE F. SNAVLEY, EXECUTIVE VICE PRESIDENT, AND MARTY M. DUNHAM, DIRECTOR OF GOVERNMENT AFFAIRS

Mr. McCluskey. Thank you, Congressman.

First I would like to introduce the gentlemen with me. On my right is our director of government affairs, Marty Dunham, and on my left, the executive vice president of the Cincinnati Board of Realtors, Gene Snavley.

I will proceed with the testimony.

When stringent monetary policies are pursued, a downturn in housing is inevitable. The inordinately large burden borne by housing under tight money conditions is vividly demonstrated in the experience of the last 15 years.

Since the late 1960's, there have been three periods when the Federal Reserve, in the attempt to slow the rate of inflation, has boosted interest rates to record levels. In each of these periods housing construction and sales have been devastated.

During the 1969–70 credit crunch, housing starts declined by almost 40 percent. In the 1973–75 period, they plummeted an incredible 64 percent, while in the more recent 1979–81 downturn they have fallen 57 percent. For the existing home sales market the 1979–81 credit crunch has been far worse than either of the earlier crunches with resale activity falling 42 percent.

In marked contrast to housing, the downturns experienced by the overall economy have been relatively mild. Real GNP fell by only 1 percent in the 1969–70 recession, 4.8 percent during the 1973–75 period, and 2.6 percent in the 1979–81 period.

We expect new construction to total 1.6 million units in 1982 and increase 1.8 million in 1983. However, these levels of production are woefully inadequate since the Nation needs 2 million units a year just to meet anticipated demand.

The severe depression in resale activity also continues. In July, resales on a nationwide basis were at a seasonally adjusted annual rate of 2.5 million units, 5.2 percent below June but virtually the same depressed sales rate reported every month so far this year.

The total number of potential transactions lost during this housing depression is staggering. So far over 2.3 million home sales with a market value of $162 billion have been lost, much more severe than either of the last two downturns. This represents a 41.5-percent decline compared to 19.9 percent and 18.4 percent for the 1969–70 period and 1973–75 period respectively.

Over the past 4 years, the combination of rapidly rising home prices and high interest rates has resulted in devastating increases in the cost of homeownership for American families. As recently as 1978, monthly payments for principal and interest for the average-priced existing single-family home financed at 80 percent for a 30-year mortgage were $382. In 1981, principal and interest payments on the average resale property with the same financing arrangements will rise to $810, 17 percent greater than 1980 and more than double the cost of 3 years earlier.

As recently as 1979, mortgage payments for the average-priced resale property took just 22.8 percent of average family income. That figure has increased to 32.8 percent and as much as 60 percent in some cities.

In our area here it is 32 to 35 percent.

Coupled with these devastating figures is the plight of the real estate practitioner. The typical income levels of brokers and sales associates in 1980 were virtually unchanged from their 1977 levels, and when inflation is taken into account the real earnings declined by 24 percent. All measures of housing activity indicate that 1981 will be no better.

Also the majority of real estate brokerage firms are small business operations; a single office with the average size sales force of 10 or fewer. In 1979–80, a significant portion of firms reported expenses outstripped income; 30.5 percent reported losses compared to only 15.5 percent in 1976–77. It is estimated that in 1981, 50 percent will report losses.

The housing depression we find ourselves in is not confined to real estate brokers, salespersons or the buying public. In 1976, there was $23.5 billion available for lending by savings and loans. That figure has dropped by 536 percent to $5.5 billion available in 1981. This reduction in availability of funds has had drastic effects on lending institutions and businesses dependent upon new and existing home sales.

Businesses which benefit from the direct expenditures which take place at the time of the home sale are: Household movers; attorneys; real estate appraisers; termite inspectors; structural inspection firms; surveyors; property insurance, and title insurance companies; and local governments which earn fees and taxes on the transaction.

Expenditures on such services vary widely. However, they generally average around 3 percent to 5 percent of the selling price of a home, typically in the range of $2,500 to $3,500 per home transaction. The impact is impressive when you consider 100 home sales in a community would typically generate $250,000 to $350,000 in ex-

penditures that occur around the time of sale. This is in addition to the earnings of real estate practitioners and mortgage lenders.

It has also been proven that homeowners preparing for the sale of their property will average between $500 and $1,000 in expenditures for fix-up activities. The sale of 100 homes in a community could be expected to produce an estimated $50,000 to $100,000 in expenditures. Overall, recent home buyers during their first year of occupancy outspend nonmover homeowners by $2,000 to $2,500. These are additional expenditures in the 12 months following the sale that would not have taken place in the absence of the sale.

When comparing these two categories of expenditures to our local market, the potential loss to our community is between $1.5 million to $2.25 million, based upon M.L.S. statistics which indicate a decline of 500 home sales since August of 1980.

The multiplier effect exhibited through these examples of residential real estate can similarly apply to commercial-industrial real estate as well.

Locally we have seen a drop in our membership of 14 percent with a projected decline throughout the State of 25 percent by 1982. We have experienced a decline of total dollars of listings sold in 1979 to 1980 of $118 million with another 8 percent decline for 1981 through August. Many real estate brokerages have experienced a 50 percent or more decline in transactions. Finally, from 1979 to 1981 we have seen a 42-percent drop in resale activity throughout the State.

A recent article prepared by the Associated Press indicated that of the 33 major metropolitan areas, Cincinnati ranked 27th in terms of market conditions for a viable real estate market.

That means there were 6 major metropolitan cities that had worse conditions than we had, out of the 33 in the Associated Press article.

Mr. LUKEN. That is not based on size.

Mr. MCCLUSKEY. No. It just says major metropolitan areas.

Mr. LUKEN. The fact that Cincinnati would be one of the smaller metropolitan areas would not necessarily put it in that lower bracket.

Mr. MCCLUSKEY. No. I think they are talking about general overall conditions on a percentage basis, comparing market conditions probably on a percentage basis.

Mr. LUKEN. In other words, a smaller metropolitan area like in Arizona or someplace.

Mr. MCCLUSKEY. I don't know their definition for major metropolitan area. The point is of the 33 chosen, which are representative of sizes that are close to ours, that ours is 27th down on the list. It sort of surprised me, by the way.

There is no easy solution or short-term approach that will take us out of this depression. However, we do have recommendations that we believe will help assure improvements in the economy.

We recommend: First, the President and the Congress should make good on their commitments early this year to hold spending to $695 billion for fiscal year 1982 instead of busting the budget by $10 billion announced by the administration in July, another $10 billion in the appropriations process in the Congress and as a result of bad estimates.

Second, if spending restraint proves unlikely because of inadequate leadership or courage to trim defense, nondefense and/or entitlement programs then the across-the-board 10 percent personal income tax rate cut scheduled for July 1, 1982, should be deferred to 90 days until October 1, 1982, and the same action may be needed on the July 1, 1983 tax rate cut.

Third, whether by spending cuts or tax relief deferral, the deficit should not exceed $42.5 billion in 1982 and decline in 1983 to a balance in 1984.

Fourth, we urge the Congress to encourage the Federal Reserve Board, (a) to allow the growth of money to achieve the midpoint or upper end of their targets instead of below their target; (b) to adopt a secondary interest rate target range, such as 13–16 percent for short-term rates, to reduce excessive fluctuations which alone have accounted for one-forth of the decline in the interest sensitive sectors of the economy.

We understand the target is between 3.5 and 6.5 percent, and they have been hanging at the low end of that target. If they could release that possibly a percentage point, they would stay within their target and give us what we need.

I am digressing a little bit here.

Mr. LUKEN. I think this refers to the question or the subject that was raised earlier: By these corollary policies, we are putting the brakes on, on the one hand, and stepping on the accelerator on the other hand. And you are saying ease up on the brake a little bit.

Mr. MCCLUSKEY. I guess the best analogy is a new term I have come up with called tourniquet economics. That means you have to tighten it up to save the leg, but if you don't let it loose a little, you lose the leg. We agree there is a tightening process. We are willing to bite the bullet so to speak. But we are at a point right now where we have to have a little easing within that target range in order to spur activity within our industry. It is a critical situation right now. I have indicated the losses of our members within our association.

I think one thing we have to contend with that is very important is the attitude of the public and the people that work within the confines of our industry. We need that shot in the arm right now, that easing a little bit of those constraints on the interest rate. We are not talking about 10 or 12 percent at this point. We are talking about easing it down a couple of percentage points to get the market spurred.

As I say, we do concur with the fact that you have to tighten things up somewhat, earlier in the year. But now is the critical time to ease it up a little bit.

We urge the President and the Senate to appoint and confirm a qualified small businessperson from the interest-sensitive industries as the next replacement to the Federal Reserve Board, expected January 1982.

We urge the Congress to insist upon implementation of all savers certificates including the congressionally mandated tie that three-fourths of the net funds go for housing and agricultural loans.

We would like to see an expansion, an extension of the all savers certificates, realizing the problems with the short-term certificate.

We would also like to insure somehow that the funds do go into housing as they are supposed to.

Mr. LUKEN. FNMA doesn't fully qualify, does it?

Mr. MCCLUSKEY. FNMA has come up with a regulation that that is part of the qualification for the 75-percent funds. But they came out with that announcement about 2 weeks ago. We were surprised by the announcement. We have registered our complaints with Mr. Maxwell and indicated that if that occurs, it won't give a shot in the arm to the local community that we need.

Finally, we encourage the promulgation of appropriate regulations that will insure timely and complete disclosure by depository institutions on the amount of savings inflow resulting from the ASC and the type of investments these institutions are making with the funds.

This concludes our testimony at this time. We certainly would like to thank you for the opportunity to appear here.

Mr. LUKEN. Well, I am not being unduly complimentary, but I think your testimony is very cohesive and concise and would really answer any of the questions that I would have. You have addressed in your digressions a couple of the questions that have been raised.

Mr. Dalton, do you have any questions?

Mr. DALTON. Mr. McCluskey, the people that you are selling to now, how are you helping them finance that sale?

Mr. MCCLUSKEY. At the present time and throughout the past year we estimate with some degree of credibility that probably 50 percent of our sales are being handled with some type of creative financing. The big question, the No. 1 question, is affordability. We have not reached a point yet, we don't believe, where the buying public is not willing to buy a home, even in light of the costs that we have. They realize the economy we live in but the big key is affordability.

There have been all kinds of financing techniques and alternative mortgage instruments that have been used to try to make a home affordable. Fifty percent I guess of our transactions have been handled by some type of creative financing.

Mr. DALTON. Sort of like owner financing?

Mr. MCCLUSKEY. Yes. The savings and loans have come on board with some different kinds of mortgage instruments. There is no complete answer at this point. We are trying to create situations hopefully that would be long range. But right now we are dealing with some short-range solutions. The savings and loans and owner financing are probably the two key ways.

Mr. DUNHAM. I would like to add something. One thing I think we are looking at—the gentleman from the Savings and Loan League mentioned this—if we could sell homes at 15.5 percent. No doubt it would be very difficult. But with the volatility in the market as it stands, if in fact we can produce some sort of mechanism whereby the Federal Government in balancing its budget, coming close to it, and having a strong monetary and strong fiscal policy, and of course allowing the savings and loans to have alternatives in basically getting more money—and I am speaking specifically of pension funds going into the mortgage market—I believe that we can reach a point where we can have stability in interest rates.

I think once we get down, hopefully, to the 13- or 14-percent level, that we will see the market again coming back up. I don't think we will ever reach the levels that we had in the boom years, so to speak. But we do have to recognize that stability is probably the main theme that many of the public are going to have to look at. And, of course, the housing needs are there. So I think stability in interest rates to a 14- or 13-percent range, allowing the thrift institutions to also have liquidity, and of course keeping their expenses down, is very crucial.

Mr. LUKEN. Well, I compliment you gentlemen, particularly Mr. McCluskey's testimony—without necessarily agreeing with it, but I must say I am inclined to agree with it.

Locally and nationally, real estate people are addressing these problems, and they are coming up with some very definite conclusions and recommendations, which can serve as an initial basis of discussion. I appreciate that. I think the Members of the Congress and the administration will also appreciate it.

Mr. MCCLUSKEY. Thank you.

I would like to make one final comment, if I might.

We have tried to approach this from a commonsense point of view and tried to look at the big picture of what actually can be done. So we have tried to delve enough into it, that the recommendations that we make are possible.

But ultimately the final word from our members, the members of the housing industry, and the savings and loan industry, is really time has run out. We need help and we need it quickly.

So I would like to leave that critical issue just laying there. We need help right now.

Thank you.

Mr. LUKEN. Thank you very much, gentlemen.

Next we will hear from Dr. George Vredeveld, Greater Cincinnati Center for Economic Education, University of Cincinnati. Dr. Vredeveld, thank you for coming today.

TESTIMONY OF GEORGE VREDEVELD, GREATER CINCINNATI CENTER FOR ECONOMIC EDUCATION, UNIVERSITY OF CINCINNATI

Dr. VREDEVELD. Thank you. I think that you have my formal statement. I find that many of the remarks that I had planned to make have already been made. So perhaps I can emphasize a few points which I think deserve emphasis.

Mr. LUKEN. That would be appreciated. We will receive your testimony into the record.

[Dr. Vredeveld's prepared statement follows:]

PREPARED STATEMENT OF GEORGE VREDEVELD

I am pleased to address this distinguished group this morning. As you know, it is not always popular to seek the opinions of economists. Consequently, it is heartening to know that an economist's services are still in demand. There has been considerable debate recently among economists as to where our economy will go. Our crystal ball has been so clouded that it has been said that, "Economists are always half right in their forecasts. But, they never know which half it will be." Because I do not know which half it will be, I will not focus on predictions, but rather on causes and possible remedies of high interest rates.

In my remarks I will address the strong relationship between the rate of inflation and interest rates, causes of inflation, and other factors which have created upward pressures on interest rates.

If you will, I would like you to imagine that I have before me a black box. This black box is magical in that one year from now, October 3, 1982, it will spit out ten $100 bills. The question I wish to ask is how much you would be willing to pay for this black box. The amount depends on your expectation of inflation. If you are confident that there would be no inflation, you would be willing to pay a higher price than if you expected inflation. For, if you are certain there would be no inflation, you would lose nothing due to a decrease in the value of the purchasing power of the $1,000. However, if you expected inflation, you would pay less for the black box (i.e. demand a higher discount as a type of compensation) because, after a year, the purchasing power of the $1,000 would decrease. Buying or selling this black box is very much like loaning or borrowing money. To buy the box you are giving up money now for the promise of future payment. To sell the box you are accepting money now with the understanding that you will not have the $1,000 at a later time. With high expectations of inflation, the buyer of the box needed a relatively large compensation for the use of his money—this compensation is similar to interest payments.

As in buying a magical black box, an important factor influencing interest rates is the expectation of inflation. If the expectation of inflation is great, the lender of money will need a large compensation (or high interest rate) for loaning money, the value of which will be much less when it is paid back. The borrower of money will be willing to pay the higher compensation, or a higher interest rate, since he can pay back the loan with less valuable dollars. If both parties entered into this negotiation voluntarily, the question might be "Why is this so bad." Once again, expectations of inflation become an important factor. For we are never certain what the inflationary rate will be, and consequently, we will postpone major purchases if we feel that the inflationary rate and interest rates will decline. Accordingly, certain industries that produce these products realize a significant decrease in the demand for their products. Futhermore, high interest payments can cause serious cash flow problems for individuals since the monthly payments become a very high percentage of one's income. Once again, the effects of high interest rates become particularly painful for certain industries, many of which are represented here today.

If we were to stop here, the way to deal with inflation appears simple and the solution is obvious. All we must do is to stop the expectation of inflation and interest rates will fall. I am confident that if inflationary expectations fall, interest rates also would fall, but the costs of reducing inflationary expectations can be high. One way to reduce inflation and inflationary expectations would be to correct the imbalance between total spending and total output. This can be accomplished by reducing the growth in the money supply, something which the Federal Reserve Bank recently has done. However, when the growth in the money supply is reduced, the price of money (or interest rate) will increase. In this situation, as in the case for other goods, a reduction in the supply of loanable funds with no change in its demand will increase the price of money, or interest rates.

Presently, it seems we are in this situation. The Federal Reserve Bank has tried to control the rate of growth in money and, therefore, the supply of money has decreased relative to demand. In spite of the tight control of money, inflationary expectations apparently have not yet decreased significantly. Taken together this leads to very high interest rates. Our present policy also have hurt severely our thrift institutions since it has raised considerably the short term interest rates but has had lesser impact (albeit still a large one) on long term rates. This so-called inverted yield curve has increased the costs of borrowing to a greater extent than revenues from mortgages made at long term rates. Solutions are not easy. If we were to increase the money supply, this would cause a short term reduction in interest rates, but it would fuel inflationary expectations. Consequently, an increase in the money supply would be a very short term solution and in the long term it would mean even higher interest rates.

I have already alluded to one cause of inflation, an imbalance of total spending and total output. This is only a partial explanation. Government deficits also have created inflationary expectations and have forced interest rates higher. When the government runs a deficit, it must borrow money in order to cover that deficit. The two main sources for borrowing this money are from the Federal Reserve Bank or from the general public. When the government borrows from the Federal Reserve Bank, the money supply is increased and inflation is stimulated. However, if the government borrows from the general public, there will be no serious impact on inflation, but it does significantly increase the demand for loanable funds. Accord-

ingly, as with other commodity, the price of money or the interest rate, will increase.

So far I have tried to demonstrate how high interest rates are caused by expectations of high inflationary rates and by increases in demand for or decreases in supply of loanable funds. Recently, we have seen that in addition to the Fed's efforts to restrain the growth in the supply of money, the loanable funds which normally come from individuals and corporations have dwindled. Individuals have not found saving to be profitable. Interest revenue is taxed (with the exception of some special cases) and the purchasing power of their savings decreases through inflation. Frankly, there are few incentives to save. Furthermore, real loanable funds from corporations also have decreased. Although it appears that retained earnings by corporations have been reasonably high, real retained earnings are less because of the effects of inflation and deficiencies in accounting practices to deal with them.

Recently, much attention has been focused on efforts to decrease the rate of inflation and interest rates by stimulating production. In commenting on this effort I would like to go back once again to the relationship between total spending and total output. Whereas previous efforts have focused on limiting total spending, a "new breed" of economists, the supply siders, have focused on total output. Essentially, these econcomists have argued that inflationary pressures can be reduced by increasing output by providing incentives to produce more and to work more. These incentives for the most part have included tax reductions and tax breaks for certain categories of people. Although the jury is still out on the effectiveness of this approach, it does seem clear that the reduction of taxes runs the risk of increasing total spending more than increasing total output, and consequently, inflationary expectations are stimulated.

Are there easy solutions, or perhaps, are there any solutions? My preference is to focus on long term. This involves continued control of the growth of the money supply and a reduction in government deficits. To reduce the activity of the government in credit markets would be of great help. If people see that they will actually be ahead by saving, and if they are convinced that inflation will not significantly reduce the purchasing power of their savings, interest rates will fall, supply of loanable funds and working capital will increase. All of this should lead to greater output, investments, and productivity. The costs of a policy of this sort are severe. But, I am not convinced that they are greater than a policy which would not control monetary growth and government deficits.

Dr. VREDEVELD. I think that we have heard a lot about the rate of inflation, interest rates, Government deficits, supply and demand for more money. And clearly they all have a strong influence on interest rates.

What I would like to do for a moment is to focus on the relationship between inflation, and especially expectation of inflation, and interest rates, and this will deal with Federal Reserve policy.

I think it is very important to realize that interest rates depend very strongly on what expectations of inflation will be, and not necessarily on what inflation is.

In order to understand this perhaps it would be worthwhile to use an analogy which I have used in my classes. I ask my students if they will imagine that I have before me a magical box which a year from now will spit out ten $100 bills. I try to convince my students this is a fool-proof box, it will actually work. And the question then becomes how much will you pay for this magical black box.

As they consider the answer to this question, obviously what they are concerned about is how much the $1,000 will purchase 1 year from now; that is the purchasing power of that $1,000.

They quickly realize that they would be willing to offer less for the box if they feel that the purchasing power of that $1,000 would be less. Consequently, the higher the expected inflation rate, the lower price they will pay for that black box.

I suggest to you this is very similar to loaning and borrowing money. An important factor influencing rate is the expectation of

inflation. If we expect inflation to be high, indeed we will want the high interest rate if we are loaning money. And I believe that today we face a situation where expectations of inflation are still very high.

In order to lower the inflation rate, it would seem that it would be very easy. Cut the expectations of inflation. If we can get the expectation of inflation down, the interest rates will go down.

Unfortunately, it is not quite that simple.

In order to cut the expectation of inflation we could have a very strong monetary policy. The Federal Reserve Bank could limit the growth and supply of money and the expectation of inflation would decrease.

The problems, of course, have already been mentioned earlier today; that when the Federal Reserve Bank limits the growth in the money supply, the supply of loanable funds relative to the demand of these funds decreases. And as in any other commodity, when supply decreases relative to demand, the price will go up. And I think we have seen that very recently.

The problem, I think, comes when we consider what should the Federal Reserve Bank do then. If it would increase the money supply, clearly this would have a very short-term influence on interest rates, and they may go down. Unfortunately, when we increase the money supply, expectation of inflation will go up. Increasing the money supply is a very short-term solution, but in the long term it will have a rather disastrous effect.

In my mind that is exactly the situation we see ourselves in today.

The Federal Reserve Bank is trying to put on the brakes, as you have said, but unfortunately expectations of inflation have not reduced. One reason is that people recognize that the Government is still running a fairly large deficit, and the promise of reductions in the inflationary rate are not there.

We are faced with a difficult situation. And I don't see any easy solutions to this.

Let me make a couple of other comments on reduction in tax rates. That issue has also been raised earlier this morning.

There are two ways to reduce expectations of inflation. One is to reduce total spending, and the other is to increase output. We have sort of a new breed of economist called supply siders who rather than focus on reductions in total spending have focused on increases in total output, the idea being if we can increase total output, inflation will decrease. And I think some of the characteristics of the new tax act have reflected this so-called supply sider——

Mr. LUKEN. Have you heard much from the supply siders since the tax bill was enacted?

Dr. VREDEVELD. I heard an interesting interview with Mr. Laffer a week or two ago.

Mr. LUKEN. I am sure he would not be deterred. He has been the principal author.

Dr. VREDEVELD. He certainly was not deterred, that is right.

Mr. LUKEN. I have noted, and I wonder if you have also observed, the phenomenon that the supply siders quit talking very loudly as soon as the tax bill went ino effect. In fact, the transformation was so abrupt that the folks in the administration, supply siders, came

back within 6 weeks and gave us some new sets of figures which were not based upon those optimistic supply sider ideas.

Dr. VREDEVELD. I feel that the promise of the supply siders' argument was exaggerated tremendously. It usually takes at least 6 months to see the effects of policies of this sort. And I really think the supply siders defeated their own purpose in promising much more than this tax bill could ever deliver.

I also feel that the new tax bill may have been far too broad.

If you look at the incentives to increase total output, which in fact could reduce the expectations of inflation, it seems that the reduction in business taxes are appropriate. However, there probably should have been less of a decrease in personal income tax.

It is my fear that the reduction in personal income taxes, along with the other reductions, will probably expand total spending more than it will expand total output, which would make it inflationary.

If I can go back to Federal Reserve policy, I would like to state that I think it would be a mistake to increase the money supply even for a short term. I think that the financial industry has become so sophisticated that they determine interest rates on the basis of almost immediately past actions by the Federal Reserve Bank. And if they see the Federal Reserve Bank is going to increase the money supply, they are going to revise their expectations of inflation upward and their interest rates will also be revised upward almost immediately. We have seen some of this in the past.

I think we are in a situation where the long-term solutions are the best solutions and the short-term solutions are going to be disastrous for many people. But I don't think the solution in the short term is increasing the money supply.

Mr. LUKEN. Well, thank you very much. Do you have any questions, Mr. Dalton?

Mr. DALTON. You said that you expect the effects to be seen from the tax cuts and the budget cuts to show up in about 6 months or so. What exactly do you see 6 months from now, assuming that the Fed does indeed keep its tight money policy?

Dr. VREDEVELD. Your question reminds me of the statement that economists are always half right in their forecasts, but unfortunately they never know which half it is.

When you ask me for forecasts, I become a little nervous. It would seem to me that after the Federal Reserve Bank announced their policy of controlling the money supply in October 1979, and not by the way of increasing interest rates, which has been mentioned earlier—they embarked on that policy and then they got waylaid a little bit.

If you look at the growth of the money supply, it was wavering all over the place. And I think people did not know what to expect.

Over the past 6 or 7 months we have seen much more consistent action on the part of the Federal Reserve Bank.

It would seem to me if we could have 3 or 4 more months of 8- and 9-percent inflation, that people would start to believe it, especially if they could see some solutions to Government deficits, that is, if they could see they would not increase sharply.

Obviously every time the Government goes into the money market to fund its deficit—and the Fed isn't giving the Treasury too much money, in order to limit the money supply—we are going to have pressures there.

I tend to be optimistic. I would think that if we could see a reduction in inflation rates, or interest rates, of 200 basis points, it would be possible if we continue to see 8 or 9 percent inflation. That is a personal opinion and not a guarantee, certainly.

Mr. DALTON. So then you think it would be necessary to go ahead and give the President in some form his extra $18 billion of cuts for the 1982 budget.

Dr. VREDEVELD. It would be very helpful as far as interest rates are concerned, extremely helpful.

Mr. LUKEN. Wouldn't it have the same effect if a tax cut was postponed, or would that be different?

Dr. VREDEVELD. No, I think it would have a very similar effect to a postponement in the tax cut. I believe that the financial industry is looking for some sign that the rate of inflation will not continue to increase or be at 13 or 14 percent. I think they are looking for that sign.

Mr. Luken, you asked earlier why the big difference between the interest rates now and the rate of inflation. I think it is because even though the inflation rate is 8 or 9 percent now, people in financial industries are not convinced it is going to stay there. And if they could be convinced that it would stay there, I could see interest rates coming down to 12, 13 percent rather quickly, if they could be assured that inflation would be at 8 percent.

Mr. LUKEN. You think it is that simple?

Dr. VREDEVELD. I don't think what I said was very simple. But, yes, I think——

Mr. LUKEN. Aren't there other considerations?

Dr. VREDEVELD. There clearly are other considerations. There are many considerations. But in my mind, interest rates depend more on the expectation of what the inflationary rate will be than anything else. And what the inflationary rate will be depends on this balance between total spending and total output.

Mr. LUKEN. We asked Mr. Sheehan this question: Who makes money out of high interest rates, who profits?

Dr. VREDEVELD. I thought that was a very interesting question and I made note of it.

Mr. LUKEN. I think it is most interesting, because it seems that in the public domain it is asked so seldom.

Dr. VREDEVELD. Yes. Well, I think there might be some groups who could benefit from high inflationary rates and consequently high interest rates. And it would seem to me that the individual who owns a home and also controls an 8-percent mortgage or whatever that might be, if this individual wanted to sell that asset, which has an 8-percent mortgage attached to it, and could sell the mortgage, that that home would be very attractive to a potential buyer, much more attractive to that buyer than someone who would be able to offer a 13- or 14-percent mortgage. So those people who own debt at low interest rates and can transfer that debt would seem to benefit.

To a large extent, however, the savings and loans banks are not benefiting by high interest rates. To a large extent interest rates are controlled by the supply and demand for loanable funds. Consequently, those individuals loaning money are paying high amounts for it. I don't think there are too many people who benefit from high interest rates.

Mr. LUKEN. You cannot find an identifiable segment.

I am not of the impression that banks are admitting they are doing all that well under the circumstances. As matter of fact, they claim they will be doing better if interest rates come down.

Dr. VREDEVELD. From what I have heard the banking industry is not doing all that well.

Mr. LUKEN. I do know one thing. There is a large body of the public out there, I don't mean a majority by any means, but a large body of the public out there who have become addicted to the high interest rates they are receiving on money market funds. And when somebody suggests that they are going to put some reserve requirements or something on the money market funds, we get a flow of mail. Now, admittedly the stockbrokers are behind it; they are urging it to a great extent, although not completely, from what I observe. But there is a large segment of the public out there, most of whom or many of whom do have a few bucks in their pocket, they are not the poorest segment, but they are not necessarily the ultrarich by any means, who perceive that they are benefitting from the high interest rates.

Dr. VREDEVELD. I think you may have identified a group of people who could benefit through high interest rates. And those are the groups of people, and the insurance companies and the investment companies, who probably have much more flexibility, because of the lack of regulation, to take advantage of high interest rates, that is, to attract savings.

If you look at the banking industry and the thrift institutions, they cannot, because of regulations, attract savings at these high interest rates, where another group of people who have been very creative and imaginative have found ways to do that, which is perfectly legitimate and legal. But the regulations which apply to the other institutions do not apply to them.

Mr. LUKEN. Well, Dr. Vredeveld, we are going to have to go on. It would be enjoyable and profitable for us to discuss it further. I am sure you feel the same way about it.

We thank you very much for your testimony. It will be helpful to our committee and to the Congress.

Dr. VREDEVELD. My pleasure. Thank you.

Mr. LUKEN. Our next witness is Mr. Chabut.

TESTIMONY OF LOUIS CHABUT, PRESIDENT, QUEEN CITY SUPPLY CO., CINCINNATI, OHIO

Mr. CHABUT. Mr. Chairman, I have taken a little different approach than what has been discussed earlier this morning, and that is prime rate.

Prime rate, although now at 19 percent, is a contrived number and has no real relationship to present money market conditions. It is a blatant form of price fixing.

Some businesses are forced to borrow against the prime rate index and from this base points are added for actual interest charges.

Better than 60 percent of the commercial loans, according to the Wall Street Journal article that I read several months ago, are issued at rates at least 4 to 5 points below prime.

Too much control of our money markets is in the hands of the five to seven largest banks in the United States. These same banks represent approximately 40 percent of the total country's banking assets. The 200 largest banks in the country control 85 percent of the banking assets. This is out of a total of approximately 15,000 commercial banks in the United States.

We hear that high interest is due to inflation and excessive Government borrowing. Inflation is now moderating and the Federal Government, seemingly, is getting a handle on spending. Current deficit spending, as a percent of GNP, is lower today than 25 to 30 years ago, but interest rates are more than four times higher.

Prime rate was allowed by the Federal Government back in the early 1930's when, apparently, the banking industry could not price its product realistically. It seems by now that this problem should no longer exist. Congress should immediately pass a law to remove prime rate and force commercial banks in the country to price their product in the same manner that all other sound businesses price their product.

In my opinion, if prime rate is abolished by law, it would force each regional banking community to recognize its basic cost of money and price accordingly. This might reduce overall interest within the United States 1 to 2 percent, since no longer would banks recklessly buy money. They would have to purchase their product just like other businesses do, in relationship to what they expect to sell their product, and in this manner would possibly be a little more judicious in the amount of interest that they are willing to pay for borrowed money.

I see no reason why we should place in the hands of a few individuals who represent the chief executive officers of the major New York City banks the control of the destiny of the money markets throughout the United States. Also, I feel the New York City banks have a great deal of Mideast Arab oil money which is their problem, and this problem should not be forced on the rest of the country.

You were asking who might benefit from high interest. Obviously the tremendous amount of money that has been forced into our economy by the Mideast countries is obviously an an answer to your question. They obviously represent the segment that truly benefits from high interest.

Recently Kuwait removed $4 billion from Citicorp. Also it is interesting to note that Citicorp lost one point in their credit rating this past week. I am sure you read that.

High interest rates have adversely affected my business over the past 4 years. I will submit this table for the record, if I may.

Mr. LUKEN. It will be inserted in the record at this point.

[The table, referred to above, and an article from the Cincinnati Enquirer follow:]

INTEREST COST VERSUS SALES

[Amounts in percent]

	1978	1979	1980	1981
Interest costs vs. sales	2.8	3.3	3.6	[1] 3.8
Actual percent of interest cost increases over base year	([2] [3])	+36.9	+63.6	+76.0
Average bank interest increase	([2])	+17.4	+34.8	+68.9
Sales increase Company experienced over base year	([2])	+13.2	+24.6	36.0
Number of employees vs. change from base year	[2] 27.0	([4])	−1.0	−2.0

[1] Estimated.
[2] Base year.
[3] For base year 1978, industry average of profits before taxes represented approximately 3 percent.
[4] No change.

Experts Predict Chaos in Financial Markets

(By Tom Petruno)

Rochester, N.Y.—In the not-too-distant future, major banks and corporations will default on their loans, U.S. Treasury bills will be yielding 28 percent and Mexico and Venezuela will be Communist countries.

And there will be no escape for America from "the inevitable catastrophe": the breakdown of democratic society and the rise of a dictator.

Those predictions come not from psychics writing in the National Enquirer, but from some of Wall Street's top money managers and market analysts.

Several hundred investors paid to hear those experts speak at an investment conference in New York City last week. Many of them were there to find out what they should do with their money in the 1980s.

What they heard from several of the speakers was that it might not matter.

Keynote speaker for the five-day conference, for example, was Julian Snyder, a highly respected market analyst who writes an investment letter called International Moneyline.

His message to the conference: "Our civilization is now economically, socially and morally untenable. It was built on money, but money is now wasting away."

There is no escape, he said, "from the inevitable catastrophe"—the collapse of our society. All investors can do is keep their funds in Treasury bills and hope they survive what's coming, he said.

Snyder and many of the other "gloom-and-doom" analysts who spoke take the attitude that such worldwide problems as inflation, terrorism, depletion of natural resources and overpopulation are virtually unsolvable now.

What is more, they say, America is living on borrowed time because it is living on too much borrowed money. And they don't believe the Reagan administration's economic recovery plans have a chance for success.

"It is said that Ronald Reagan is being too tough." Snyder said. "I say he's not being tough enough."

Snyder sees the Federal Reserve eventually relenting in its tight-money policy in order to keep interest rates from going higher and destroying American business. "We will eventually see the greatest money-printing in our history, followed by the greatest inflation the world has ever seen," he said.

Irving Weiss, a Florida-based analyst who has been studying the money markets for more than 20 years, said he is advising his clients to liquidate everything they can and get ready to put it all in 90-day Treasury bills.

His reasoning: There is $5 trillion in credit now outstanding in America, and so much of it has been put on in recent years that $1.2 trillion of it must be refinanced within the next 12 months. There is no way the markets will be able to absorb that crunch, Weiss said.

"We're looking for a major explosion in interest rates," he said. He predicts 90-day Treasury bills will hit 28 percent in a few months (they're yielding about 14 percent now), and that some major banks and corporations will default on their debt.

Harry Schultz, a London-based analyst who writes a respected economic letter, told the conference via satellite that the current downturn in U.S. interest rates is "not the real thing."

Instead, rates may rise dramatically, he said, "and the risk of one or more money-market funds collapsing is acute in the near future." If rates rose sharply, the funds might see their capital flee to Treasury bills.

Ralph R. Goldman, senior vice president for investments at Bache & Co., said the prime lending rate is likely to rise to 25 percent by November with the upswing in interest rates. The prime rate is now 19.5 percent.

Goldman said that "in spite of President Reagan's good intentions, his program will fail." Eventually, the government will tell Americans, "We are going to have gradual inflation," because the problem is intractable, he said.

Goldman also predicted that communists will take El Salvador "within the next six months." If that happens, he said, "Mexico and Venezuela will be next."

But not all of the conference speakers were so negative on the future. Some, like George Gilder, a supply-side economist, insisted that Mr. Reagan's program will restore prosperity.

Others, like Otto Roethenmund, head of Deak & Co., said, "We have seen collapses" of currencies and markets before. "But we are all still here."

Mr. CHABUT. Due to ever-shrinking profits, due to the extremes of interest as shown in the table, the company does not have an opportunity of growing or advancing in our markets. This problem definitely weakens our position with major national distributors with ability to borrow at lower rates of interest.

An example of how large corporations benefit at lower interest rates would be Dayco Corp. who is a supplier for Queen City Supply Co. in V-belts and industrial hoses.

I have their 1980 corporation annual report right here. It indicates if Dayco had paid the same average interest cost that Queen City Supply paid in 1980 they actually would have lost money.

Dayco's average interest for 1980 was 6.4 percent.

Queen City Supply Co.'s average interest for 1980 was 17.8 percent.

Interest charges for Dayco would have been $16,106,718 greater than what their annual report shows. The profits before taxes, as their annual report for 1980 indicates, were $11,686,000. Thus by charging the increased interest charges against this profit, they would have actually lost $4,420,718.

I bought Queen City Supply Co. in December 1977, when prime rate was 8 percent. The company was purchased on a highly leveraged basis, which I am told is typical of my industry. I had no idea that prime rate would go to 22.5 percent which, as you know, it already has, and with rumors now being floated around that it will go as high as 28 to 30 percent by the end of 1981, which is rather interesting. No one has commented on that today, as far as this morning's discussion is concerned.

I am not going to belabor the whole point of this particular article that I picked out of the Enquirer about a week ago. This is not the first time I have seen this article, where this particular group of people met in New York City. They paid to listen to these economists. Again, they are reemphasizing the point that by November, as recently as November, we are to see prime rate increased to 25 percent, even though recently we are seeing it come down slightly.

What I am wondering is, Mr. Luken, what are you going to do when you see prime rate go to 28 to 30 percent. And if you have not had the chance to read this article, let me pass it to you. It is rather interesting.

About 2 years ago, when prime was around 10 to 12 percent, people started telling us it was going to be 20, 22, 25, and I didn't believe it. But interestingly enough, it arrived at that point.

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I have no access to borrow funds outside of my region, but the Cincinnati regional banks have access to money outside of our area such as through Euro-dollars, and so forth. Major corporations in the area have the same benefits. Thus, prime rate totally penalizes my business when the average cost of money for regional banks is approximately 10 percent.

The regional bank costs are around 10. They are able to index against prime. Profits like that I would like to see.

Banks also have the ability as you know to hide profits through reserve for bad debt.

These same banks, even though their cost of money is 10 percent, still are able to index their loans to small business against prime rate, which, as you know, only recently has moderated to 19 percent. I realize the cost of money possibly for the New York City banks is somewhat higher, but this is not my problem.

In my opinion, history has never shown that high interest rates slow inflation; they just fuel the problem. With cost of money being so high, there is very little incentive to expand due to extreme low R–O–I. Thus a continuing shortage of goods keeping prices high, whereas industry expansion would increase the quantity of goods, bringing cost down—supply-side economics.

As to a solution, as I mentioned before, Congress should immediately pass a law removing prime rate as a national index that commercial banks freely use.

Second, the Federal Reserve bank reviews money supply; however, they do not recognize when they gage the demand for borrowed funds whether it is domestic or foreign. Congress should place a ceiling on all foreign loans above a certain level and these should be subject to review by the Department of the Secretary of State as to whether these loans are truly in the best interest of the United States. At the present time, the five to seven of the largest banks in the country are loaning money to the so-called Third World at a higher rate than what we, as a country, are providing in foreign aid.

There is no chance of repayment from many of these countries, and of course the bailout will be the Federal Government, and that is us, the taxpayers.

Third, another level of control, unfortunately, should be placed on all major corporation mergers. Recently Du Pont and Conoco produced a tremendous demand as far as money markets are concerned. At the present time, these are growing at an absolute frenzy, again placing undue pressure on the amount of lendable funds available in the financial markets. I will have to take exception to Secretary of the Treasury Regan in that bigness does not necessarily create greater efficiencies. In fact, by the results of two very large corporations, we can obviously see that bigness creates total inefficiencies. And we have Chrysler and International Harvester as an example.

Huge corporate mergers do nothing as far as creating new jobs but, in fact, diminish job opportunities. This has been evidenced in all recent major mergers. We have gone through this before, back in the early seventies. A study should be made as to how successful these hugh corporate mergers have been, since I am positive you will be absolutely shocked as to the number of these companies

that have changed their structures, meaning they have now shed the companies earlier purchased.

It is a known fact that small businesses create more new jobs than large corporations. It is also a known fact that small businesses represent the largest employment in our country. It is high time that the U.S. Federal Government recognizes the strength in our country and stop penalizing the small business via prime rate.

Mr. LUKEN. Mr. Chabut, your testimony is very substantive. It is individual. You speak from your own experience. You had some comments and suggestions which are different from those that have been offered before, and somewhat fresh.

I know one of our subcommittees is also considering the question of the prime rate and the inequities of the prime rate.

I wonder if we can in this climate, though, pass a law that removes the prime rate.

Mr. CHABUT. Why not? I am not allowed to index. Why should they? If they are allowed, everyone should be allowed to index.

Mr. LUKEN. You are not allowed to index?

Mr. CHABUT. I have no index I can price against. And most other businesses are in the same situation.

Mr. LUKEN. You are saying that it should not be allowed anyway, regardless of whether we pass a law.

Mr. CHABUT. It should not be allowed, right. It should not be allowed. It is price fixing. Been that way since the early 1930's.

Mr. LUKEN. I think there are legislative proposals—I am not totally sure what they are—which would address the problem. At least as far as I am concerned, it is helpful to have this kind of light shed upon it. I intend to study the various proposals.

Mr. CHABUT. Very good, I appreciate that very much.

Mr. LUKEN. Thank you, Mr. Chabut. We will keep in touch.

At this time we will hear from Mr. Harlow, Mr. Cargile, and Mr. Gartner.

PANEL CONSISTING OF JAMES HARLOW, WILLIAM CARGILE III, AND JOHN B. GARTNER, JR.

TESTIMONY OF JAMES HARLOW, EXECUTIVE SECRETARY, GREATER CINCINNATI BUILDING & CONSTRUCTION TRADES COUNCIL

Mr. HARLOW. Good morning, Mr. Chairman.

I am James Harlow, executive secretary of the Greater Cincinnati Building & Construction Trades Council, comprising more than 15,000 members, many of whom I am sorry to say are unemployed at this time with no assurances that this picture will change in the foreseeable future. It is even worse than we experienced in the early 1950's.

Unemployment among building trades members is running overall about 25 percent. However, among the basic trades, or sometimes referred to as the architectural trades, it is as high as 50 percent, which consists of the laborers, carpenters, cement finishers, ironworkers, roofers, bricklayers, plasterers, and lathers.

The mechanical trades are somewhat better off, due to several larger jobs which are still underway. But I should point out they too will be laid off due to completions very soon.

There are not enough new jobs starting to take up the slack which would provide for continuity of work, startup versus completion.

There is a good deal of work on the drawing boards, but due to the uncertainty of the financial climate and especially the high interest rates to finance such projects, nothing of significant size is coming out of the ground.

It should also be explained that this season of the year historically has been the time when building tradesmen could expect full employment due to the ideal weather for building, and the race against winter to get jobs closed in.

Building tradesmen have in the past been able to go to other cities for work when local work was not available. However, this year other areas are also faced with the same unemployment problems we are. Therefore, those who were fortunate enough to meet the eligibility requirements for unemployment have signed up for those benefits. Some, I am sorry to say, have exhausted their benefits and the 13-week extension by the Federal Government was stopped this past June.

My members are losing their health and welfare benefits, not receiving pension fund credit, and due to the uncertainties of social security many are being forced into retirement.

The high interest rates have all but stopped new housing starts and the workers in the housing construction field are moving into the commercial and industrial construction field where they can, thereby again putting more building tradesmen out of work, due to their willingness to work for less.

At today's high cost of building, contributed to mainly by high interest rates, land cost and materials, many owners and developers are settling for less than a quality job. They tend to look at the bottom line rather than the quality of work in comparison with the bottom line, which will in the long run cause the quality of work to fall drastically.

Our minority training programs are suffering from lack of jobs. We don't have the openings in our apprentice training programs. Many programs have been either curtailed or set back. We are not getting the new trainees coming into our local unions.

In my judgment, the construction industry is more affected by the outlandish high interest rates than any other industry, and the economy cannot get back to normal until the construction industry is put back to normal. And interest rates are the major key to unlocking the doors to full employment.

I just heard this morning, as an example, coming down here, the Marble Hill Nuclear Power Plant is being constructed downriver at Madison, Ind. It started out with a figure of $3.4 billion to construct that plant. It is expected it won't go online for another 4 years. It is also anticipated in that 4 years the high cost of the interest rates will cause the cost of that project to soar to over $4.2 billion due to the high interest rates.

I appreciate the opportunity to appear here this morning to give you my viewpoints and hopefully you can carry this message back to Washington and get some sense back to the high cost of borrowing money.

Thank you.

Mr. LUKEN. Thank you, Mr. Harlow.

TESTIMONY OF WILLIAM CARGILE III, CARGILE CONTRACTORS, INC.

Mr. CARGILE. Good morning. I have two things to say. They will be short and to the point.

One is how the interest rate is affecting contractor, and the other is a suggestion to Congress to think about the Small Business Administration.

First of all, the high interest rates are significantly affecting contractors, especially if you are a small business, minority contractor.

For example, say we take a job for $1 million. Our overhead and profit are about 5 percent. And the job is expected to last a year.

If you have to go out and borrow money and then pay 17 or 18 percent for the money, you may only be able to charge 5 percent for your profit and overhead together. And then with the owner holding a 10-percent retainer until the project is complete, you are losing money. And I think the Government is going to lose a lot of small contractors because they cannot compete.

So, considering that we do have a Small Business Administration, what I would suggest is that perhaps we ask small business to possibly establish something like a startup fund—especially if you have to have a performance bond, so that the owner is not that much at risk. The Small Business Administration could implement a startup fund or maybe even the owner who you are doing business for. However, if the money has already been appropriated for that job, he may be concerned that you might not complete the job if he does allocate startup money.

But for most jobs that are over $25,000, you have to have a performance bond anyway. So, he would not be that much at risk.

The second point I would like to address is the Small Business Administration—I would like to ask Congress to think about asking all Government agencies to deal with putting some of their projects under the Small Business Administration, say $2 million to begin with. There is no way that a small contractor can compete with the bigger, giant contractor. They have enough liquid assets to sponsor their own projects. A small contractor who has to go out and borrow money at 18 or 20 percent, would have to inflate that into the project, whereas a larger contractor who is bidding on a $2 million or $3 million project can bid the job at a much smaller profit because he has enough money to finance it.

I know some Government agencies currently do deal with the Small Business Administration, putting some of the projects under their supervision.

I don't think the cities are dealing with that, either. I specifically don't think the city of Cincinnati deals with the Small Business Administration, by putting some of their projects under the administration.

Mr. LUKEN. Small business set-asides.

Mr. CARGILE. Yes. I am not talking about the small business 8(a) set-asides. That has already been dealt with. I don't think the cities deal with small business set-asides at all. For instance you may have a project come up at $2 million, and you have some small

contractor that could do that project. But then there are big contractors who already have a lot of jobs in progress—perhaps 100 million dollars' worth of work on the books, on hand. These contractors can go out and take that job for maybe 1 or 2 percent and still make more money than the small contractor. And I don't think the cities are dealing with that.

Mr. LUKEN. Well, they should.

Thank you very much, Mr. Cargile.

TESTIMONY OF JOHN B. GARTNER, JR., MEMBER, GARTNER, BURDICK, BAUER-NILSEN, INC., ARCHITECTS

Mr. GARTNER. Thank you. I am Jack Gartner. I am a member of the firm of Gartner, Burdick, Bauer-Nilsen.

Like all of the other industries that have been represented here, we, too, are affected by the high interest rates. Some of us, however, are relatively busy. Our firm is fortunate. We are. I would like you to know some people are surviving in the economy and doing relatively well. We are either lucky or good. I like to think it is a combination of both.

The interest rates have a direct effect on our industry and on our business.

I would like to offer you a very hands-on, day-to-day kind of thing.

About 3 years ago when the interest rates went down to about 14 percent, in 1 day's time that was announced, I received five phone calls from clients whom we have done business with. It was almost like they were out buying shirts or dresses or hats or coats. It was remarkable. In that day and the succeeding weeks we probably signed up about 8 million dollars' worth of construction work. We are now building or planning or designing that particular portion of the work. Those moneys were appropriated at that time. They are now coming to fruition, those buildings.

However, what we see down the line is pretty grim.

We don't see work coming—even though stuff on the board right now has been assigned because of previous commitments made by institutions.

One of the primary problems coming out of this when we talk to lenders, and I do talk to lenders, because I am in the business development side of it, as well as assisting in financing—many large sums of money are going into these corporate type of mergers. That money is simply no longer available to us in the construction industry. We would not want to put that money out at long terms. It is very difficult for us to sustain our efforts in that capacity.

Our industry, at least the architectural side, has maintained a fairly level type of employment in the last several years. But we have not increased employment. Our firm has not increased employment. Other firms I know of have not increased employment. So that what we are not seeing is the growth I think we in our country need. And these needs are a direct effect of this and are causing us to have some long-term things that are going to be very detrimental to our industry, at least as I see it, for the next 2 or 3 years ahead unless something happens in the very short term to allow moneys to become available for construction.

There are two industries—one is the governmental work in the construction side, and the private sector. Governmental work—and I am not talking just about Federal Government, but counties, cities, building firehouses, a whole variety of projects that are built by local communities—these are affected—who raise their funds through taxation. That is a very unpopular term, increase of taxation. Inflation causes other kinds of moneys to be used for maintenance of schools or paying salaries in schools to simply not be there for capital improvements.

So high interest rates have a very, very detrimental effect on the industry which we support.

The private sector, of course, is directly affected by that since they are borrowing on a first-hand basis and they, too, have cut back tremendously in the past few years.

Thank you very much.

Mr. LUKEN. I think what you are saying, Mr. Gartner, emphasizes what has been said throughout this hearing; that is the degree of the effects of high interest rates on our whole economy and therefore on our society, upon our lives. This observation apparently is not appreciated by enough people at all levels.

Personally, I think that part of the reason is that we have been lulled into thinking, since we have had the experience of high interest rates and then the lowering of interest rates, that inevitably this is going to be a temporary occurrence. We have not been accustomed to dealing with it with the idea that we are going to have to solve it, because it has always more or less solved itself. And up until the last few months many people have advocated, and they still do to a certain extent—but not as many—that this is a necessary economic wrenching that we are going to have to go through. These persons state that we are going to have to dry out the economy, going to have to take all the fat out of it. But they don't come up to the realization, facing it squarely, that we are going to have to do something about it.

I am complimentary personally to organizations like the real estate people who have come in with specific recommendations—whether those are the ones that are eventually adopted or not, whether they are the wisest or not—there are specific recommendations. And I think that is what we need. I think we need to do something different from what we have been doing as far as allowing the Federal Reserve to continue in its operation, going down one track on a monetarist approach, while fiscally the Government, the private sector, wants to go down another track.

Mr. GARTNER. You asked who benefits. I can tell you a large segment of people that are benefiting from high interest rates. And that is people like my Mom and Dad. My Dad is so happy he cannot see straight. His house is paid for. He has some money in the bank and social security. And he talks to me every day about where he is going to put his money next week. He doesn't have a large sum. But he thinks of $1,000, putting it at 15 percent or 16 percent—in increments of $1,000.

Mr. LUKEN. He is fortunate to be benefiting on the one hand. But not being in the high income bracket, he is not penalized.

Mr. GARTNER. I have several aunts with $100,000. The families worked all their lives. That is a lot of money, or it was. They are

getting $15,000 plus social security. They pay rent someplace or own a little house. They are benefiting dramatically.

There is a large sector of people in our country that are benefiting in that way. Those are a large group of people—the over-65 group that have a buck.

Mr. LUKEN. I suspect that there are some people who are of even greater means than your aunts, though, who are not admitting it, and they may not have their financial records or statements out there for public view.

I personally am grateful to this panel and everyone for your attendance and for the presentations. It encourages me; I think we should continue this kind of investigation, and also that we should take some action as the Federal Government upon these recommendations that have been presented.

I thank you very much. This session of the subcommittee is adjourned.

[Whereupon, at 12:30 p.m., the subcommittee was adjourned, to reconvene subject to call of the Chair.]

[The following statement was received for insertion in the hearing record:]

WESTERN HOME CENTER, INC.,
Cincinnati, Ohio, September 29, 1981.

Hon. THOMAS A. LUKEN,
3409 Federal Office Building,
Cincinnati, Ohio.

DEAR CONGRESSMAN: I'm sure there is nothing more I can say about interest rates that has not already been said. Interest rates are killing businesses large and small.

We in the lumber and building supply business are affected in several different ways. First of all high interest rates have caused us to cut back in all phases of our business and lay off people. We are going backward instead of forward. We cannot afford to borrow money at 20 percent to finance growth. Secondly, the major part of our business is done with the building contractors. They represent 70 percent of our volume. When you have 18 percent mortgage interest rates, who can afford a house. I don't have to explain that to you, I'm sure. This 70 percent represented approximately ten million dollars in sales in 1979. In 1980 this portion of our business was down 35 percent and in 1981 that percentage is going to be greater.

What is our employment situation? In 1979 we had employed at any one time as many as 180 to 190 people, now we have 130. Actually we should lay more people off because we are not making a profit. If things do not get better real soon this will have to be considered.

The other 30 percent of our business is done with the consumer. Everyone thinks this part of our business should be booming—wrong. There are two very good reasons. First of all interest rates for remodeling are too high and secondly, if they do have cash they have put it in some form of money markets and are having the time of their lives collecting 16 percent to 18 percent dividends or interest.

How long can you stay in business and lose money. For some of us maybe longer than others. Sooner or later something has to give. When business doesn't make a profit you don't pay income tax. How can government cut their deficits if they are going to receive less income taxes from business. If government doesn't cut their deficits, interest rates will not decline.

The main causes of high interest rates have to be inflation and large government deficits. Interest rates are controlled by the government. When you see the rate of inflation dropping you have to wonder if the government is really interested in seeing any drop at this time. What about that large deficit?

The solution has to be for rates to slowly decline. Too fast a drop would only cause bigger problems later. The people lending mortgage money have to be able to compete with other money markets. Right now one of their biggest competitors is the government with their T-bills. The other is the money markets. Where will our future mortgage money come from?

Your concern and attention to our dilemma will be most appreciated. Thank you for listening to me.

Sincerely,

ED FRIESZ, *President.*

HIGH INTEREST RATES AND THEIR IMPACT ON SMALL BUSINESS

MONDAY, OCTOBER 5, 1981

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ANTITRUST AND RESTRAINT OF TRADE ACTIVITIES AFFECTING SMALL BUSINESS,
COMMITTEE ON SMALL BUSINESS,
Youngstown, Ohio.

The subcommittee met, pursuant to notice, at 9:30 a.m., in the Federal Courtroom Annex, West Front and Market Street, Youngstown, Ohio, Hon. Lyle Williams (acting chairman of the subcommittee) presiding.

OPENING STATEMENT OF ACTING CHAIRMAN WILLIAMS

Mr. WILLIAMS. We will call this hearing to order.

Before we begin, I want to tell you that Chairman Luken is on his way from the Cleveland Airport and should be arriving here very shortly. I have worked with the chairman for a long time and he likes to start on time. I am sure he will be pleased to know we are going to begin, and he will join us later.

The purpose of the hearing today is not to come up with any new information on what is happening in the interest rate area; we all know what is happening. I think my concern and that of the chairman is simply that we think we are on the right track as far as the national policy goes, to try to correct what appears to have been happening here in the past 10 years which has caused the economic crisis that we are in and as a result the high interest rates we are suffering from, and certainly that you know so much about.

Hopefully, the national policy will begin to answer those concerns very quickly. Hopefully, we can bring the interest rates down, I think, slowly, and keep them down, rather than have them come down quickly and go right back up as we experienced last year.

The thrust of the hearing is to get input from the small business individual throughout the country, to help Chairman Luken, myself, and the other members of the Small Business Committee to prepare legislation, after gathering this information, to prevent this from ever happening again.

I think it is essential that the Small Business Committee, being one of the most important committees in Congress, get your input. I think you see signals in our economy that maybe we do not see as quickly as you do. Therefore, the information we gather on anticipating will be very helpful to us, to prevent this from happening

again, as well as, hopefully, perhaps somebody has a solution out there that can correct it very quickly.

We are struggling as a nation, as a congress, and as a society, as we try to deal with the interest rate problem. All of us know it is the most significant factor in shutting this country down, especially those in the small business community. Therefore, I am looking forward to your testimony.

I ask that you keep your statements brief and to the point. I am sure we will have some questions to ask of all of you, trying to pull out the information we need.

With that, the first panel we will call will be some representatives from the financial community.

First, we will hear from Don McKay, president of the Home Savings & Loan, and Mr. Jeff Francis, First Federal Savings & Loan.

TESTIMONY OF DONALD McKAY, PRESIDENT, HOME SAVINGS & LOAN, ACCOMPANIED BY JEFFREY L. FRANCIS, ASSISTANT VICE PRESIDENT, FIRST FEDERAL SAVINGS & LOAN ASSOCIATION, YOUNGSTOWN, OHIO

Mr. McKAY. Mr. Williams, unfortunately I don't have a prepared statement for you. To be perfectly honest, I had a phone call last week about the hearing, and the next thing I knew about it was when I read in yesterday's paper that I was supposed to be here today. So I didn't have time to prepare a statement.

Basically, the impact of the high interest rates on the real estate and construction industry, and consequently upon ours, has been catastrophic.

Just as a simple example, in the month of August we made 135 loans. Less than half of those loans were involved in construction or purchase of real estate. In 1978, in the same month, we made 440 loans, the bulk of which were at that point involved in construction and purchase of real estate. In 1979, that figure dropped to 265, and in 1980 191, and then down to 135. So we are down to something in the nature of 25 percent of what our normal mortgate business would have been.

At the same time that the volume in loan numbers was going down so sharply, our assets and deposits were increasing. We are a much larger company than we were then, so that proportionately it is even worse.

This further data might be interesting to you.

The dividends that we paid out to depositors in 1979 through the month of August were $18.5 million. In 1980 that figure was $26 million. In 1981, through August, the figure was $35 million. We have literally doubled our expense of dividends in that same period. The impact of that on earinings for all savings and loans has been catastrophic.

I keep using the word catastrophic because that is what it has been.

When we make 1 month 50 loans for the purchase of existing houses as opposed to what normaly would be at least 250—because usually in August the houses that were started in the spring are starting to be completed and each one of those new houses that is purchased and each one of the old houses purchased creates a new

sale—it has an ongoing impact. When that figure drops as sharply as it has, it means that the people who want to buy cannot buy.

We noticed in the last year or so that people no longer really were concerned about the interest rates. They had been so inundated with high rates that they were perfectly willing—not willing, that is the wrong word—they were accepting the high rates. It had come down to the point where the principal concern was: What was the monthly payment? If they could afford the monthly payment, they would go ahead and make the purchase.

Of course, as the rates go higher and higher it froze more and more people out so there were fewer and fewer people that could afford the monthly payment necessary to make a purchase.

That, in general, has been our home savings experience.

We have had to develop a complicated set of rules regarding the various rates that are to be applied. Instead of having two or three rates that apply, we have something like 12 rates to cover various situations.

We have been doing our very best to make money available to people who want to buy or to build a home. But it has simply come to the point where, with a rare exception, people cannot do it. So for all practical purposes, in my opinion, the real estate industry and the construction industry have in some cases ceased to exist.

More and more builders are unable to continue, more and more are going out of business.

The real estate companies are even having a great deal of difficulty in getting their salesmen to come to the office in the morning because there is nothing for them to do.

The impact on the real estate and construction industry not only in Youngstown but nationally is nothing other than a pure out and out catastrophe.

Mr. WILLIAMS. Thank you.

I think I would like now to go ahead and hear from Mr. Francis and then maybe ask some questions.

Mr. FRANCIS. Mr. Chairman, I have gone a different track here, I guess, from Mr. McKay. I have a written statement that certainly I will paraphrase.

The topic of discussion here is high interest rates and its effect on small business.

I see a number of small businessmen sitting here who are probably better able to deal with those effects, on an immediate basis, than I might.

I have concentrated my effort on the deregulation process that is occurring in the depository institutions industry.

H.R. 4986, in March 1980, set in motion the deregulation process. Congress placed its confidence in a newly created entity known as the Depository Institutions Deregulation Committee, and assigned it the task of conducting an orderly, and I quote that "orderly" phaseout of interest rate ceilings over a 6-year period of time. I would suggest at this point that confidence has been abused.

The Federal courts to date have agreed with that suggestion on two separate occasions in lawsuits brought by the U.S. League of Savings Associations, the first holding that the proper administrative procedures were ignored and the latest invalidating an accelerated phaseout schedule.

It is obvious the Congress is concerned about high interest rates. We have just seen the enactment of the All-Savers Tax Act, which gives some hope of being a success.

Unfortunately, the DIDC has recently chosed to increase the passbook savings rate by 50 basis point, which is half of 1 percent, over the repeated objection, by the way, of Chairmen Volcker and Pratt, they, of course, being the Chairman of the Federal Reserve Board and the Chairman of the Federal Home Loan Bank Board, both of whom are well aware of the impact on both the banking and thrift industry.

There are statistics floating around now this will cost the savings and loan industry alone, which has been the leading source of real estate creidt for many years—they hold three times as many mortgages in dollars as the banking industry, which is of course a much larger industry. Anyway, it appears it will cost the thrift industry about half-a-billion dollars annually.

Real quick somebody could get smart and say that is going to help the depositors; I am all for helping the depositors, but I did a little arithmetic. Our small association has approximately $205 million in total deposits—passbook and saving certificates—17,700 passbook accounts averaging $3,400 a piece, for a total of $61 million in passbook savings. What is that average passbook depositor going to receive, what benefit are they going to receive as a result of this increase?

I assumed a passbook depositor having taxable income of $8,500 a year total, which would put that person in a 21 percent marginal tax bracket, obviously about the lowest tax rate we could assume. I find each one of the 17,700 depositors is going to amass wealth by accumulating an additional $1.12 per month. Incredible upward pressure is going to be placed on interest rates in order to pay a whole lot of people very little money.

I was going to be humorous and try to give examples of what someone could purchase for $1.12 a month, but really I could not find anything that was that cheap—not even a gallon of gasoline.

There are a lot of examples of the DIDC's unknowing blundering into the future in terms of deregulation. A classic example is, in January of 1980, the thrift institutions and the banks were authorized to offer the small saver certificate, which is the popular 2½-year savings certificate; the rate on which is pegged monthly to Treasury issues.

In February 1980, the indicated rate would have risen to 13.75 percent for the thrifts. It was determined by the Federal Reserve Board, Federal Home Loan Bank Board, FDIC, and the National Credit Union Association that a ceiling of 12 percent should be placed on this type of account. I have a quote here. "This action is necessary because the agencies believe that a sudden increase of this magnitude—to 13.75 percent—would be disruptive to many financial institutions."

You might guess the DIDC reversed this position in July of this year. For the 2-week period just ending, September 15 through September 28, this rate stood at 16.55 percent.

Again, some simple arithmetic: 16.55 percent if 2.6 times higher than 12 percent than is 13.75 percent, and it is a fair inference to say that it was 2.6 times as disruptive.

In my written statement, I have a couple of more examples, and I will skip over those.

A continuation of the haphazard deregulation process will certainly cause a shrinkage of the number of depository institutions. And I think this relates heavily to small business.

Local banks and thrifts will become parts of regional and national holding companies. And there are some benefits of efficiency. As an example, if Ohio were to be considered not a good risk lending area, when we have this incredible concentration of assets in the money center industries, we could see the grandest example of redlining in the history of credit, where it would be deemed we just don't lend money in Ohio. The money market fund industry has now successfully drained in excess of $140 billion in savings and credit from local depository institutions and the communities and businesses they serve.

In closing, we have ow or we are coming very rapidly to the point where a hardware store in Cortland, Ohio, seeking $3,000 for inventory financing, will have to compete for that capital with a steel mill expansion in Argentina. I am not sure that is efficiency.

Thank you.

[Mr. Francis' prepared statement follows:]

PREPARED STATEMENT OF JEFFREY L. FRANCIS, ASSISTANT VICE PRESIDENT, FIRST FEDERAL SAVINGS & LOAN ASSOCIATION

Mr. Chairman, my name is Jeffrey Francis. I am Assistant Vice-President of First Federal Savings and Loan Association of Youngstown, Ohio. Further, over the past several years, I have lectured at Kent State University and Youngstown State University on the topic of Real Estate Finance.

I appreciate the opportunity to testify before this committee.

While I understand the topic of discussion is to be the effect of high interest rates on small business, I'm sure other individuals are infinitely more qualified to address directly the small business issue. Rather, I have concentrated my effort in the area of the relationship of the financial institutions deregulation process to the uncertainty in the depository institutions with the resultant effect on small business.

By enacting H.R. 4986 in March of 1980, the Congress set in motion the deregulation of depository institutions. Congress placed its confidence in a newly-created entity known as the Depository Institutions Deregulation Committee (D.I.D.C.) by assigning it the task of conducting an orderly phase-out of interest rate ceilings over a six year period. I would suggest to you that this confidence has been abused. The courts, to date, have agreed in two different suits brought by the U.S. League of Savings Associations: the first holding that proper administrative procedures were ignored; and the latest invalidating an accelerated phase-out schedule adopted last June.

The Congress has demonstrated its concern as to high interest rates, in part, by enacting the All-Savers Tax Act, which began operation this past Thursday.

This action has now been undermined by recent action of the D.I.D.C. to increase the regular savings account rate by 50 basis points, over the repeated objections of Chairman Volcker and Pratt. This 50 basis point increase will increase the cost of operation to the nation's savings and loans by a half billion dollars per year. (I would remind you that the savings and loan industry has been the leading source of real estate credit for many years.) Consider, please, the impact the effect of this half-billion dollar increase in cost to the already depressed real estate and construction industry. You may respond by stating that our depositors will benefit by this action. I would counter that argument by reminding you that while the aggregate payment is massive, it is so widely dispersed so as to give little benefit to the average passbook depositor. For example, our association has approximately 205 million dollars in total deposits; our passbook account base consists of 17,700 accounts totaling sixty one million dollars, with an average balance of $3,400. Brief calculations reveal that serious upward pressure will be placed on interest rates so that each of these 17,700 depositors can increase their disposable income by $1.12 per month after taxes. (Using the 21 percent marginal tax rate of a depositor with only $8,500 in total taxable income.)

Consider another recent action by the D.I.D.C. In January of 1980, banks and thrift institutions were authorized to offer the small saver certificate (S.S.C.), which is a 2½ year fixed rate savings certificate, the rate of which is pegged to treasury issues. In February of 1980, the indicated rate would have been 13.75 percent for thrift institutions. (Note that 2/80 precedes the creation of D.I.D.C.) It was determined by the Federal Reserve Board, Federal Home Loan Bank Board, Federal Deposit Insurance Corp., and the National Credit Union Administration that a ceiling of 12 percent should be placed on this type of account. The reason for their action? "This action is necessary because the agencies believe that a sudden increase of this magnitude (to 13.75 percent) would be disruptive to many financial institutions." The D.I.D.C. reversed this position in July of 1981. For the two week period of 9/15—9/28 this rate stood at 16.55 percent. Considering that 16.55 percent is 2.6 times higher than 12 percent than is 13.75 percent, would it be fair to infer that this is 2.6 times as disruptive as the sudden increase that was averted in February, 1980.

Speaking to the issue of disruption and uncertainty, consider that the final regulations affecting All-Savers Certificates have been amended twice in the past two weeks; and while hundreds of millions of dollars are now invested in these types of accounts, I fully expect further revisions of "final regulations" to occur.

While there are many more examples of D.I.D.C. actions showing total disregard for small and medium sized institutions and the communities they serve, I'd like to focus for a few moments on the effects of this and other activity on small business.

A continuation of the haphazard deregulation process will certainly cause a shrinkage in the number of depository institutions. As local banks and thrifts become parts of regional and national holding companies, loyalty to local communities and local business cannot continue; imagine the concentration of savings and credit of millions of households and businesses in the hands of a few Wall Street "money managers." For example, if Ohio was considered not a good risk lending area, we could see the grandest example of redlining in the history of credit. This merger syndrome is working in concert with the money-market mutual fund industry, operating outside and frustrating the conduct of monetary policy. The money-market fund industry has now successfully drained approximately 140 billion dollars in saving and credit from primarily local depository institutions and the communities and businesses they serve.

In closing, I would like to suggest that if the forces vigorously at work today are allowed to proceed unchecked, a hardware store in Cortland, Ohio seeking three thousand dollars for inventory financing will have to compete with the construction of a steel mill in Argentina for the necessary capital. Please tell me, is this efficiency?

Mr. WILLIAMS. Thank you very much for your statement.

I would like to get an opinion from both of you first of all on whether or not you think the direction, the legislative direction, that is being taken in Washington is the answer to the high interest rate problem, and if you do, how soon do you see it having an impact?

Mr. MCKAY. You say the legislative direction.

Mr. WILLIAMS. The so-called Reaganomics.

Mr. MCKAY. All right. I think very strongly that if it is given an opportunity, and if people will hold to it long enough and suffer the slings and arrows that they are going to take that it will have an impact.

The basic concept behind it I think was faulty in one respect. The reduction in Federal spending was mandatory, necessary, emergency, and whatever other word you want to apply to it. I think there was a lack of wisdom in reducing Federal income tax at the same time. In spite of the fact that I pay a fairly heavy tax, I would rather personally have seen the income tax reduction delayed until such time as there had been a positive effect from the reduction in Federal spending.

But be that as it may, if enough time passes so that $50 billion is taken out of the arena in which people are competing for money,

and by that I of course mean the Federal Government, if enough time is given for that to have an impact, rates will fall.

Now, the question is how far and how soon, and I don't think anybody knows.

For 4 or 5 months we have been hearing a tremendous volume of conversation and discussion about the impact of Reaganomics. Unfortunately, Reaganomics is only 5 days old at this point, so it has not had a fair chance.

I think the reaction of people on Wall Street and the money interests there is a very good indication that they have serious questions in their minds as to whether or not people really are going to hold to the line that they have established. Are they really going to do it or are they just talking about it? If they really do it, it will work. If they just talk about it and yield to political pressure, it will not work.

Mr. FRANCIS. I would echo Mr. McKay's opinion. The tax reduction, in my opinion, should not have occurred probably at all, but at least not until there were some significant impact from the cut in expenditures. The obvious problem is if the Federal Government has to finance this continued deficit, there will continue to be high interest rates, because at least a fair portion—and I don't cast arrows at the Government because they are only one entity, and there happens to be 220 million unique individuals out there going their own direction. However, the Government certainly is a major force in the economy, and if they have to fund the kind of deficit it appears they might have to fund over the next 12 to 14 months, I'm afraid we are going to see interest rates staying high.

Mr. WILLIAMS. I want to ask you one final question.

I think there is a conception in some parts of our society that somebody is doing well with high interest rates. And I suppose they may look at a financial institution and say, well, really they are making money off of high interest rates.

I know, and I think those in the business community know, that is not the case.

But the question I want to ask is: Is there anyone who benefits from high interest rates?

Mr. MCKAY. Surely, of course there are.

Mr. WILLIAMS. Tell me who.

Mr. MCKAY. The people who have money to invest and no obligation to somebody else. Anybody who has had money available to them for investment during these periods of high interest rates must have done very well. But of course those people don't owe something to somebody else, as opposed to the financial institutions where, yes, we charge high rates now and get larger income; at the same time, as I quoted earlier, the cost to us of obtaining that money is more than double.

Mr. FRANCIS. I would counter your statement regarding savings and loans profiting from high rates with the actual profit and loss statistics. For 1977, 1978, and 1979, net income for all savings and loans after tax, ranged from $3.2 billion to $3.6 billion; 1980 was $833 million, down to approximately one-fourth of the preceding year. And I would think that possibly we are going to see some brackets around that when we see the 1981 figures. That is, the thrift industry as a whole will lose money in 1981.

People who have saved money, saving meaning not spending it, have not been paid an adequate return since probably at least the midfifties, maybe even before that. We all have heard "Go in debt as deep as you can." We made it real, real smart to not save money. The people who saved are now reaping probably a greater reward than their economic contribution.

Mr. WILLIAMS. So there is someone in this society who does benefit from high interest rates, no question about it.

Mr. MCKAY. Surely. But that is not the financial institutions.

Mr. FRANCIS. Not at all.

Mr. WILLIAMS. At this time we welcome Chairman Luken, from Cincinnati, the person who is truly responsible for the hearing.

Mr. LUKEN [presiding]. I didn't hear your testimony, but I certainly appreciate your help. We all need a lot of help in this area.

I was just reading an article in the Wall Street Journal on the way here with reference to the situation of banks today, with interest rates. The article pointed out, among other things, that many of the smaller banks are actually suffering because of the high interest rates. I am sure you are well aware of this because these banks have a lot of the long-term, low-yield loans, similar to the savings and loans.

Mr. FRANCIS. We are both from savings and loans, so that we are well aware of long-term, low-yielding investments.

Mr. LUKEN. Even the banks are having that problem.

Thank you very much.

Mr. WILLIAMS. At this time we would like to hear from the automobile dealers. Mr. Dick Barrett of Barrett Cadillac, and Jerry Thorpe of the Auto Dealers of Eastern Ohio.

TESTIMONY OF RICHARD BARRETT, PRESIDENT, BARRETT CADILLAC, ACCOMPANIED BY JERRY THORPE, AUTO DEALERS ASSOCIATION OF EASTERN OHIO

Mr. THORPE. Mr. Chairman, I am Jerry Thorpe of the Automobile Dealers Association.

When we were originally contacted by the Congressman's office here, we felt that maybe we would bring in three or four automobile dealers to testify. But after thinking it over, talking it over, we felt that Dick Barrett should be our representative. He is not only an automobile dealer here locally, but he is also a national auto dealer representative for Ohio.

With that, if there are some questions I would be happy to help out. But I think Dick is our spokesman.

Mr. BARRETT. Thank you. I have a few brief statements.

I think in our industry the problem is twofold: It is the problem that the dealer has with floor plan costs, and then the consumer problem on the other end.

Just a brief background.

Traditionally new car inventories decline in July from the previous month's level as dealers and manufacturers begin preparing for the model changeover. This July, however, for the first time in 16 years, domestic inventories increased. And, at the end of July this year, we had 1,675,000 cars in inventory.

"Suffering" is the right word. Because of higher wholesale vehicle costs and higher interest rates, per unit floor plan costs for the

dealer were 110 percent higher than in July a year ago. Given these higher floor plan costs the average dealer would have to reduce his current inventory level by 60 percent just to get his floor plan expense back to the level of a year ago when such expenses were already astronomical. That is not comparing the figures to 2 or 3 years ago.

Just to give you a brief idea, in 1977, as a percent, our new vehicle gross floor plan costs averaged 10.8 percent. The new vehicle department in an average dealership showed a 2.4-percent operating profit on sales in the new vehicle department.

In 1981, floor plan costs for the first 6 months averaged 28.1 percent, and the new vehicle department is not operating at a profit.

So that gives you an idea from the standpoint of what those costs have done to the dealer.

Of course this has had a tremendous effect on attrition of dealers. It reached a high of 650—the number of dealers we lost in the first quarter of 1980. It has declined now to where we are losing around 225 dealers a quarter.

In January 1979, we had 28,850 retail automobile dealers. Today we have 26,250. It appears the last quarter of this year that you could see this attrition pick up again considerably. Our problems are not behind us from that standpoint.

Here locally, we have lost eight dealers in this area in the last 2 years. But even, I think, more significant than that, is a random survey of 13 dealerships in the past 2 years. These dealers have had a decrease of 176 employees, which has quite an impact on the local economy.

Now, on the other side of the ledger is the consumer. Throughout the country it is a little different than here in Ohio. In some States where there has been a cap on what can be charged to the consumer, automobile credit has almost become unavailable. So even if a man can afford to buy the car he cannot purchase it. Nobody is willing to loan him the money to purchase the automobile.

In Ohio, we do have an 18-percent cap. Credit has been available, but not as readily as in the past.

It is a twofold problem from the consumer's standpoint. Interest rates on an automobile loan today relatively speaking are probably a better bargain than 3 or 4 years ago. But with that higher rate, with the higher cost of the car, the consumer has a hard time being able to afford the purchase of an automobile.

That is where we are.

Mr. WILLIAMS. Thank you very much.

I would ask you the same question I asked the last panel. Do you feel at least hopeful that we have turned the corner as far as the legislative action we have taken in Washington to help the small business community in the field that you represent, the auto dealers? Is there at least a little bit of hope out there that things might change, if they can just hold on—and I hate to use that term.

Mr. BARRETT. We have been holding on for a couple of years.

Mr. WILLIAMS. I know everybody is holding on. But is there a feeling of hope, maybe a renewed feeling if we can hold out another month or 2 months we have turned a corner on this thing?

Mr. BARRETT. I definitely feel the step we are taking in Washington is in the right direction. How much longer dealers can hold on—I have—we have ebbed the attrition of dealers in the last quarter. One of the larger manufacturers showed a profit. I think you read one of the articles recently where they were going to show a horrendous loss.

Yes, I think we are going in the right direction. But the problem is how much longer.

There is one other area that has come to our attention that concerns us. We don't know the answer to it. And I think it affects all small business people.

It appears that your larger corporations can go into financial institutions and work out an interest rate on a large loan which is very advantageous, 3 to 4 percentage points under what we now have to pay, prime plus half a percent for floor plan, which is historically pretty much the same across the country, whether you are dealing with GMAC, Ford Motor Credit, or a local bank. Yet, larger loans are being made at substantially below that. And I think this affects all small business to a great degree.

Mr. WILLIAMS. That was going to be my final question. Is there some assistance available from General Motors or whoever we are talking about as far as an auto producer? They have to be suffering along with you.

Mr. BARRETT. Their financial arms have continued to make money available. But you have to remember all dealers are not part of General Motors. Ford Motor Credit and Chrysler have continued to make money available to the consumer and to the dealers. It has been very expensive for the dealers.

Mr. WILLIAMS. To follow this up, do you see this continuing until, as we hope, we have turned a corner and it really starts to take effect?

Mr. BARRETT. It is going to continue, because we are tied to the prime rate. As prime comes down our floor plan costs decline, yes. Consumer loans, more tied to regulation in States—there again that is another problem, I believe.

Mr. WILLIAMS. Thank you.

Mr. LUKEN. You said as prime comes down.

Mr. BARRETT. I am hopeful it is going to.

Mr. LUKEN. The wish is father to the thought. Maybe that will happen.

Do you see prime coming down? I don't mean just in the short term. Do you foresee prime coming down?

Mr. BARRETT. Can I just read a brief paragraph to you? We do have an economic department at National Automobile Dealers Association:

> Not surprising, there still continues to be quite a bit of speculation on the future of interest rates. Most economists agree that interest rates will remain high, although below current levels. By any standards of the distant past money will remain very expensive. Congress has approved the budget and tax cuts requested by the President. But contrary to the expectations of the Reagan Administration this has not led to a sharp drop in interest rates.

And realistically, personally, I don't think we are going to see a sharp drop.

I think it would be a benefit to us if they were in the area of 16 or 17 percent by next April. I wish it was different than that. But I think this has to be.

Mr. LUKEN. You pay financing on your floor plan based principally on prime, is that right?

Mr. BARRETT. Based principally on prime—based totally on prime.

Mr. LUKEN. In our hearing on interest rates the other day in Cincinnati one of the witnesses who is a small business person, not an auto dealer, suggested that we undertake legislation to make prime rate illegal.

Mr. BARRETT. Just as I said earlier, this has been one of our problems, because it is discriminatory. And everything has been tied to this.

The consumer who is not affected by what prime rate is in an automobile loan perceives that he is going to pay 20, 21 percent on an automobile loan, where in effect today he is going to pay 17 percent.

So there is a problem there.

Mr. LUKEN. It is one of the areas that one of the other subcommittees of this Small Business Committee is investigating. Congressman Nowak's Subcommittee on Tax, Access to Equity Capital and Business Opportunities, is looking very closely at prime rate and the discriminatory effects of prime whereby those who are attached to prime are paying a certain rate, whereas certain bigger business and others are not paying anything close to prime. There do seem to be some obvious inequities that are resulting, and these are inequities not helping our economic situation at all.

Thank you, Mr. Chairman.

Mr. WILLIAMS. Thank you very much, gentlemen, for your testimony. It has been very helpful.

At this time we will hear from a group that certainly probably saw the earliest signs of high interest rates and felt the early results of it, and that is representatives of the real estate industry.

Kathy Miller of Brighton Realty; Robert Harrell, Harrell Real Estate; and Jim Ryan, Ryan Associates.

If you would, before you begin your testimony, state your name and firm so we may have it for the record.

TESTIMONY OF KATHY MILLER, CENTURY 21 BRIGHTON REALTY, CHAIRPERSON, MULTIPLE LISTING SERVICE COMMITTEE, YOUNGSTOWN, OHIO, ACCOMPANIED BY ROBERT HARRELL, HARRELL REAL ESTATE; JIM RYAN, PRESIDENT, RYAN ASSOCIATES

Ms. MILLER. Thank you vey much.

I am Kathy Miller, with Century 21, Brighton Realty. I am the chairman of the Multiple Listing Service Committee in Youngstown.

First, I will address my remarks to the effect of interest rates on Youngstown, Mahoning County. I think actually they correspond to the whole marketplace. I will do that with some charts.

The first chart I have says at the top: "Financing Is the Cornerstone of Every Sale." This is true. I think that is true in the

marketplace no matter what the product is. If we don't have financing, there can be no sales.

What I have done is show a 2½-year comparison of properties transferred. These are not sales just made by realtors. These are transfers of all types of property.

In 1979, we transferred 5,000 properties. In 1980, 3,591. And through August of this year, our records indicate there have been 2,300 transfers of property.

Mr. LUKEN. In the whole county?

Ms. MILLER. Yes. It is my personal opinion that during the next 90 days we will see this market deteriorate even further in Mahoning County, because we are going through some difficult times again with interest rates. But that is just to give you an idea what is taking place in the Youngstown area.

One of the things that I have access to is forecasts by Regional Data Associates, which are used by almost every housing industry to predict market growth. This is the market outlook in the Youngstown area for the next 10 years. As you can see by the little dots it will take us until about 1986 to even reach the level of housing that was sold here in 1978 and 1979. So we are in for a tough seige if we don't get some relief in terms of interest rates.

That shows the 10-year graph of how home sales will be affected in real estate in this particular county.

Again, financing is the cornerstone of every sale. Without it we just cannot sell anything.

Specifically in Youngstown, I did some research that was available to me, and that was that the average income in Youngstown predicted for this 1981 year, and it was done by Editors and Publishers Market Guide, indicated Mahoning County will have an average family income of $19,878. With that kind of average income, the potential buyer is capable of having a $414-a-month house payment. Right now in Mahoning County our average home sale is $47,900. If you earn $19,800 and you can afford a $414 payment and have $8,000 to put down, you can have a $40,000 mortgage. However, you need a 10-percent interest rate. And that is the problem, particularly in Mahoning County.

If you earn $19,800 and you are an average person buying an average home of $47,900 you cannot afford to pay over 10 percent. And 10 percent no longer exists.

So, in fact, that is true in Youngstown, that is the problem.

One thing I wanted to touch on, particularly in regard to legislation, is called the adjustable rate mortgage.

I think this is a deadly mortgage instrument that should be looked at very seriously. In the last few months the ceiling level was removed. There is no ceiling now in adjustable rate mortgages.

I just want to show you what would have happened to you if you had gotten one of these in March of 1977.

If you were the homeowner in March 1977, in Youngstown, who got an adjustable rate mortgage, you paid 8.95 percent if your rate was tied to Treasury bills. It could have been tied to the Treasury or to the National Mortgage Index. All that was 8.95 percent. Four years later if your index was tied to Treasury bills your rate had gone to 15.6 in March of 1981. That was an increase in less than 4 years of 74 percent on your home mortgage interest rate, that

caused your monthly payment to go up $312. So you went from March 1977, when your house payment was $477, to $789, solely based on the index that your lender chose to tie your mortgage to.

I have to tell you this chart was done based on increases every 6 months. That used to be a standard. You could have your index once a year, every 6 months. Now there is no ceiling. It can be done monthly.

As of September 12, the average interest rate on a committed 80-percent loan nationally was 18.22 percent. This even goes off my charts. I don't have a payment schedule that goes that high. But I just computed it, and that payment would have jumped to $904. So in March 1977, you start out at $477, in September of this year your payment would have been $904 a month. And this is allowed. This is a lending instrument that is now available. And I have to say it is deadly to the consumer and should not be allowed.

One other point on this.

In normal lending, it requires a 1 to 4 income relationship qualifying for a loan. If you were the homeowner that got this loan last March 1977, this March, when your payment jumped by $312, your personal income had to go up nearly $15,000 to qualify. And that in fact is not happening.

This is the main thing that I wanted to point out. It is called an adjustable mortgage. It was just approved without a ceiling about 4 months ago. That is the kind of legislation that the consumer absolutely must have. He must have limits on what payments can increase, and they must be responsible in terms of what they can expect their monthly house payment to go up.

This doesn't even take into consideration the fact that this homeowner also had rising utility costs, increases in his insurance, and increases in property taxes.

I don't know how many families' incomes went up $15,000 in 4 years. But if they had this kind of a home loan, that is what he had to have happen to be able to afford his home.

Let's get back to Youngstown, where the average income is $19,800. It is just an impossibility. And this is going on on a Federal scale in the national mortgage market. This is not happening yet in Youngstown. Our indexes do not fluctuate without a ceiling, other than in two institutions that I am aware of.

As far as the charts go, I thought that would give you a breakdown of what was going on locally.

Part of what a buyer needs is a guarantee of no balloon payments. He also needs the ability to refinance that property if it becomes necessary. This is a problem that exists, that no one can afford to refinance the homes they now own. And that the monthly payments must be predictable.

Interestingly, right now—the car dealers talked about their inventory—in August, there were 2,326,000 homes for sale in the United States. In Youngstown last year, about 2,500 people just gave up the chance of trying to sell. And now we have about 1,800 unsold on the market.

I think one of the most important things that is happening is what it is doing to the families. Currently about 50 percent of our inventory is vacant, at least in the resale residential market.

I had some comments from clients I have represented this past year in regard to the trauma that they have suffered, that their families have suffered, due to the fact that the great American dream of owning a home has now become a nightmare. They cannot sell them, they cannot buy them. They don't even know what they are going to do next.

One young man said his company laid him off about 1½ years ago when the plant folded. He found a job in new York. He had three young children, had been married 13 years. He commuted to New York every week. He would come home just on weekends, a 250-mile trip each way. He said:

> I tried to mend family relationships, with my three youngsters, my wife. We had an excellent marriage. After 7 months my marriage was being destroyed, my relationship with my children was terrible. The frustration we were feeling of trying to do everything we were supposed to do—we saved our money, bought our home, I was working, I went out of town to seek employment. I could not get my house sold. Now I am back in Youngstown. I have found another job. We are trying to hang together.

But the 7 months they went through being separated, not having their home sold, not knowing if the prospect would happen that their home would be sold, he said has caused almost irreparable damage to their marriage.

I cannot tell you how many cases we find with a frustration level of families just becoming intolerable over interest rates, the fact that their homes cannot be sold. They cannot move, they cannot get on with their lives. It doesn't matter what your age is. If you are young and starting out, or whether you are older and retired and you want a chance to enjoy life, you cannot get it sold, move to Florida. We are seeing frustration at all levels. It has so much to do with interest rates and monthly payments that the real estate industry perhaps sees this effect first. We saw it 2 years ago.

I don't particularly see an end in sight unless we change the manner in which we finance homes.

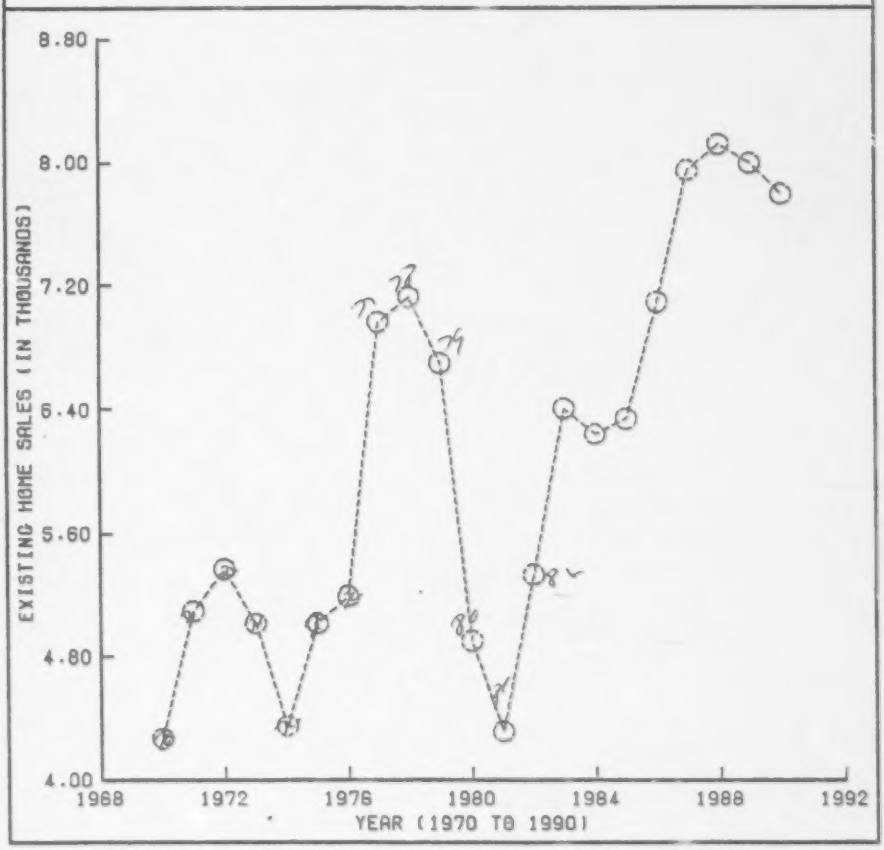
Mr. WILLIAMS. Thank you very much.

[Ms. Miller submitted the following charts to accompany her testimony:]

LONG-TERM OUTLOOK FOR THE INDUSTRY: EXISTING HOME SALES, 1970-1990

YOUNGSTOWN-WARREN, OH

O FORECAST BY REGIONAL DATA ASSOCIATES



[Exhibit 1]

Mahoning County

Average sale price MLS	$47,900
Average family income	19,878
Purchasers qualified to pay for a home on a $40,000 mortgage at 10 percent interest (per month)	414
$40,000 mortgage at 10 percent	351.00
Property taxes	50.00
Insurance	13.00
Total house payment	414.00

[Exhibit 2]

AFFORDABILITY OF HOUSING

[$60,000 Mortgage, 30-yr. fixed rate]

Interest rate (percent)	Monthly payment	Monthly expenses	Annual income needed	Numbers of families who can afford (millions)
9	$483	$215	$33,504	11.8
10	527	215	35,616	10.5
11	572	215	37,776	9.2
12	617	215	39,936	7.9
13	664	215	42,192	6.5
14	711	215	44,448	5.2
15	758	215	46,704	3.8
16	807	215	49,056	2.4
17	856	215	51,408	(1)
18	904	215	53,712	(1)

[1] Less than 1.8 million.

Monthly expenses: Insurance, taxes, utilities. Assumption: One-fourth of income goes into total housing payment.

Source: Economic Division National Association of Home Builders.

[Exhibit 3]

ADJUSTABLE RATE MORTGAGE: TYPICAL HOMEOWNER, MARCH 1977 TO MARCH 1981

	Indexed to Treasury bills	Indexed to 3-yr. bonds	Indexed to mortgages
March 1977 (percent)	8.95	8.95	8.95
March 1981 (percent)	15.61	15.05	13.35
4-yr. increase in interest rate (percent)	74	68	49
Monthly payment change	$312	$286	$204
Change on a $60,000 30-yr. mortgage	$477 to $789	$478 to $764	$477 to $681

[Exhibit 4]

FINANCING IS THE CORNERSTONE OF EVERY SALE—COMPARISON: ALL PROPERTIES TRANSFERRED, MAHONING COUNTY

	1979	1980	August 1981
Youngstown	1,721	1,332	866
Canfield	309	181	125
Boardman	849	573	375
Poland	299	205	115
Struthers	197	129	81
Campbell	120	124	91

FINANCING IS THE CORNERSTONE OF EVERY SALE—COMPARISON: ALL PROPERTIES TRANSFERRED, MAHONING COUNTY—Continued

	1979	1980	August 1981
Austintown	712	419	267
Miscellaneous	861	628	385
Total	5,068	3,591	2,305

Mr. HARRELL. Mr. Chairman, it is a pleasure to appear before your subcommittee and discuss the effects of current interest rates on our real estate industry specifically, and upon the economy generally.

I don't believe that it is necessary to discuss the history of interest or its meteoric rise in the current interest rates. These are well known and well chronicled by the news media daily. Let it suffice to say that the severe situation in which we are involved, began November 1, 1979, when the interest rates began exceeding the rate of inflation. But for a brief respite in the summer of 1980, they have continued to climb to this pinnacle at which we find ourselves today.

It is certainly my belief that you as legislators and the administration do not wish to deprive our industry of our livelihood. But this is exactly what is happening.

Many of my most respected colleagues have stated recently they are going to be able to hang on just a short while longer before giving up the ghost to the powers that be. This is represented by the fact that over 13 percent of all real estate licenses in the State of Ohio have been returned this year. And, further, it is represented by one of the largest, oldest, and most respected firms in Akron closing their doors just a few weeks ago.

This does not take into account the untold thousands in our profession who, while still holding their licenses, have had to find other fields of endeavor to earn a living instead of pursuing their real estate careers. Many of these unfortunately are some of our finest and most professional people, the kind of people our industry can ill afford to lose.

In a conversation the other day with a half dozen or so of my colleagues, we decided that our incomes last year generally were about one-third of what they had been 2 years previously and that this year they are looking for a further erosion of income due to the continued increase in the cost of operations.

We, as members of the real estate and construction industry, have stood by in recent years and watched our tax dollars being used in direct aid to bail certain large industries out of severe financial situations, ostensibly because their demise would have had too great an impact on the economy in general. And yet our industries represent many times the number of workers that we as taxpayers have assisted.

We have not asked for assistance. All we are asking for is some relief.

Yes, we have received some potential relief with the creation of the All-Savers Certificate. But its benefits were certainly curtailed by making its tax free provisions a once-in-a-lifetime benefit and its

duration of life being only 15 months, consequently modifying any potential interest reduction on the part of our lending institutions for fear of what new money would cost after the certificates' expiration.

As disturbing as the present situation is to us personally, it is equally or perhaps more disturbing for the effect it has on our clients. If our present ratios of housing payments to income are to be retained, and most lending institutions are doing so, a drastic revision in the beautiful dream is going to have to be made, a revision that I do not believe the American people are going to be willing to accept.

For example, with a $50,000 mortgage for a 30-year term at 12 percent interest, with taxes and insurance being approximately $80, it would require a payment of $518.9 and a yearly income of about $24,900. At 13 percent, that payment increases to $633.10, with an annual income of $30,400. And at 18 percent, which we all know is being asked in many cases today, that payment increases to $833.54, requiring an income of $40,000.

This change in rates has in fact occurred over the past 3 years. And I, for one, have not had the privilege of working with many who have had the luxury of their incomes increasing 60 percent in that same time frame.

Therefore, these people are no longer able to buy the same property that a few short years ago was easily within their grasp.

I would like to cite a couple of examples that have happened to some of our clients. One is a case of a State highway patrolman who had had a 25-percent down payment on a property. When his purchase agreement was signed on a Friday, he very easily qualified for his loan. The next week when he made his application, the rates had risen and he became very much a borderline case. The following week when his application was to be considered, the rates had risen again and there was no way that his loan application could be approved.

What has happened as a result of this? The house is still for sale, the owners have not been able to proceed with their plans, the agent lost income, and the patrolman still sits in his apartment very disgusted with his lot in life.

In another case, I was called out to list the property. It seems that in the 3 years since the home was purchased, they had to give up one of their incomes because of family additions and felt if they reduced their standard of living, somewhat, life would be more comfortable for them. They had purchased well and wisely and stood to increase their amount of equity by about four times, mostly through appreciation. However, it didn't take us long to discover even if they reduced their total investment by a third, which they were willing to do, their payment structure would be somewhat higher than it presently was.

These horror stories are happening time and time again.

In trying to analyze what has happened, why it has happened, and its relationships to the laws of economics as I studied them in my college days, I find myself thoroughly confused. I really do not feel they should be discarded, swept under the rug temporarily or completely altered. They basically are as true today as they were then.

We have seen a degeneration of the all-important American work ethic. However, I think I see, and I hope it is not my salesman's optimism showing, a swinging of that pendulum back to where it should be. I think our wage structure has gotten somewhat out of kilter with relation to work performed. Recessionary times have a way of correcting this, too.

The old law of supply and demand is just not working in our industry. If it were, we would be having a major real estate depression on our hands. Pricing has not moderated in relation to the numbers of people who can afford the same property today. But in our area, the rate of appreciation has declined from the 12.69 that it did between 1978 and 1979 to an appreciation factor of 7.17 in 1980 and 1981, bringing it more in line with today's inflation rate.

Then we come to the question of the interest rates and why they do not follow the old pattern of the prime being several point above inflation and mortgages being at or somewhat below inflation. The simple answer is the cost of money. Why do we have the cost of money so high? Primarily Government involvement and borrowing which is artificially supporting the rates where they are.

We have tried to look down a number of different avenues for potential solutions. We find at every intersection, barring further progress, Government spending and primarily Government borrowing. Somebody in Washington has to be willing to pay the rates which ultimately create the money market rates which in turn directly affect our mortgage rates.

I have often said if there was some way to bet the Government out of the money market for just a couple of months, we would be so busy we could not keep up with it. But we all realize this cannot happen.

There is a tremendous pent-up demand for housing right now. But there is now way it is going to be released until the interest rates are allowed to fall more in line with the rate of inflation.

We realize and appreciate fully the anti-inflationary psychology and pressures being exerted by Washington, and we are in complete accord with this. But we do feel that the automotive, lending, construction, and real estate industries have shouldered more than their share of the burden. There has to be some way devised to tighten credit, consequently control inflation, without disproportionately affecting the largest work force in our country.

Perhaps a permanent continuation of the All-Savers Certificate, or some similar program may be our answer to give us some of this much-needed relief.

But primarily we need a free financial economy in which to operate.

Mr. WILLIAMS. Thank you very much for a very thoughtful statement. Next we will hear from Mr. Ryan.

Mr. RYAN. I am Jim Ryan, president of Jim Ryan Associates and president-elect of the Warren Area Board of Realtors.

Bob and Kathy have given you a lot of specifics and figures. Because of the time, I will get right to some personal views that the people I represent are looking at.

The present legislation as we now have it is not working. The All-Savers Certificate is not going to work. It is a specific amount

of money for a specific amount of time. The banks are still looking down the road to what is going to happen to that money at the end of the 15 months.

I, as well as a lot of other brokers that I work with, have been subsidizing their own business for the past 2 years and there is really no relief in sight. I think that if we used the national figures for qualifying for assistance in food stamps, we could all stand in line.

We in Trumbull County are going to lose 20 percent of our membership this year to private industry. We have no idea how long it will take to retrain these people who have been in our real estate profession anywhere from 5 to 15 years, to bring in new people to be professional, ethical salesmen that are going to be advantageous to our business.

Because of the high interest rates we have eliminated the first-time home buyer from the market. It is cheaper to rent than to buy.

There is no help in sight. Starting the first of the year, when I will be president of the board of realtors, I may have the distinction of being the first unemployed president of the board of realtors.

We must make it advantageous for people to put their money back in their savings account. We have got to bring up the interest rates of the savings account, bring down the certificates, the other high interest factors that the people are investing in, get it back into the savings account, for the banks and the savings and loans to use their ratios to loan the money out.

Thank you.

Mr. WILLIAMS Thank you very much.

I think I said at the outset, when we introduced you, your industry is probably as affected as any, and your testimony certainly substantiates what Mr. Luken and I have heard all over the country as well as a great deal in Washington.

If you could make a suggestion as far as legislation, and really that is why these hearings are held, what would you suggest that Members of Congress do legislatively to correct the situation as quickly as we need to?

I think that is the most frustrating part for a Member of Congress, as well as for all of you.

All of us are grasping, I think, for answers to the question that has impacted us. I think we would be remiss in this hearing if we did not ask members of your profession to make a suggestion to us—if it is a continuation, as Mr. Harrell indicated in his statement, of the All-Savers Certificate—I think you need to let us know that as associations. Of course, that is why you are here representing those people.

Let's start with that and give you the opportunity to make a couple of more suggestions.

Ms. MILLER. I would like to comment. There is one thing that is not a solution that is currently pending. Mr. Pratt of the Federal Home Loan Bank Board is now trying to get Federal legislation regarding the due-on-sale clause. The banking industry is not, of course, in the same position as I am in recommending this. But

until there is a solution to real estate financing, the due-on-sale clause must not come under Federal legislation.

In California, for example, where the courts have overridden clauses with the due-on-sale they have been able to keep their real estate market alive because of mortgage assumptions at the existing rates.

I would be very opposed to seeing Pratt's recommendations go forward on that. And I think you are in a position to prevent that from happening.

We need Federal legislation that allows homes to be sold on assumptions, not disallowed, which is exactly the way we are going at the moment.

I think that if anything the only reason that homes have sold in this past 2 years is the fact that our banks have cooperated on mortgage assumptions even though they have adjusted rates. We have used blended rates. We have used various vehicles. It is not enough, though. It only takes care of about 50 percent of the people who want to buy or sell real estate. The rest don't have the ability to do it. But the due-on-sale clause for immediate attention is very important to our industry.

Mr. RYAN. I agree with Kathy on the due-on-sale clause, that we do need some help in that area. If we cannot qualify a buyer at a higher interest rate, at least give us the opportunity to have that buyer buy that home at the current interest rate; that if the seller does not sell the home anyhow, the bank is going to hold that mortgage until whatever time comes he is going to be selling it.

Again, the high interest certificates, which of course is tied to the prime and the budget itself, it is very important that we must bring those down to get the people to put the money back into passbook savings; bring the interest up on those passbook savings to make it advantageous.

Mr. HARRELL. Continuing the All-Savers Certificate is a good idea. It obviously is selling very well here so far in the first couple of days it is in effect. I would like to see a continuation of that.

I think more important to us, though, is not legislation to control any particular facet. We have enough controls now. But if there is some way we can have some effective influence on the T-bill autioning today, for example, if the Government was to come in and say we are only to give x percentage today, I think the T-bills would still sell. Consequently, I think the prime and your money markets would ride right down to scale with it, and then we would get into an area where we could handle interest rates as far as making sales are concerned.

Mr. WILLIAMS. Thank you very much.

Mr. LUKEN. I wonder if I could ask you a question.

You advocated in your testimony a free market. Of course we get into some conflicts here.

I am one of those who advocated strongly the All-Savers Certificate program. However, if we should make the All-Savers a permanent program, that would be a flat-out subsidy of the home building industry, on a continuing basis—an intervention by the Federal Government in this case, a complete contradiction of the free economy or the free market. Those are the kinds of contradictions we get into.

Mr. HARRELL. I look at the All-Savers Certificate as being a half-step. It is something that is better than nothing.

What would affect things more would be if we could get the Government's purchase, establishment of the T-bill rate back down to the rate of inflation that we have now, which has been acceptable to the financial community for years. If that factor alone were controlled by some method, then the rest of the market would get to it.

Mr. LUKEN. But here is the other part of it. Congress just adopted the President's economic recovery program. Part of that program was the big tax cut. The big tax cut it is now generally recognized—and you tell me if this is wrong—is responsible for the continuation, as a matter of fact the increase, of the deficit. The deficit you rightly pointed out means the Government goes out and borrows money and thereby keeps up the interest rate.

Now, your organization nationally and your organization in Cincinnati, has advocated a postponement of the effective date of some parts of the tax cut.

I don't know whether you want to comment on that.

Your organization also has suggested an easing up by the Federal Reserve on the money supply. I noticed in the Wall Street Journal this morning that the President is now recommending the Federal Reserve also ease up on the money supply.

I might conclude that the Cincinnati realtors' representative in making this reference to the Federal Reserve's policy of tight money and a continuous policy of tight money which keeps up interest rates, said that by comparison when one applies a tourniquet, occasionally that tourniquet must be loosened or the patient will die.

It seems to me that is a good analogy, a good figure of speech; if we have the Federal Reserve continuing the tight money policy over a long period of time, high interest rates are going to continue and the patient will eventually die.

Mr. HARRELL. Reversing this a little bit, if I may ask a question here, what has happened to the age-old theory that when interest rates are reduced, actually Government revenue increases. It happened in the Kentucky administration's reduction of income taxes. It has happened every time the income tax is reduced. I have not seen any discussion on that or any hope for it, or anything. But this has always been a factor in the past.

Mr. LUKEN. You mean tax rates reduced.

mr. HARRELL. Yes. When tax rates have been reduced, Federal revenue has been increased.

Mr. LUKEN. Well, I don't claim to have all the answers. But we have just gone through the experience where the President did say that if the Congress passes the tax cut everybody will feel better right away and things will get better right away. All we know is that that has not happened. As a matter of fact, prospects apparently have gotten dimmer since we passed the tax bill. Generally speaking, that seems to be what I read in the Wall Street Journal today. But there are those who would say what you are saying. I cannot argue with you.

There are those who say give the economic program time to work. But that is where we come down to people in your situation,

because you happen to be on the front-end of it, in the most acute state of this problem that we have with interest rates. So many people in your profession are saying we cannot give it time to work, we are going to have to tinker with it to some extent.

I suspect postponing the application of some of the tax cut and easing up on the money supply may be devices that we are going to have to resort to if the economic outlook does not improve.

Mr. HARRELL. I think that is right.

Mr. LUKEN. Whether we do or not, I don't know. I just mention that your organization nationally has been courageous enough—they don't claim they have all the wisdom, either, but whether they are right or not, they have been courageous enough to say this is something we should do.

Mr. WILLIAMS. Thank you very much for your very thoughtful testimony and your input into the hearing today.

Because of the time restraints both Mr. Luken and I have, we are going to ask the building industry as well as the small businessmen we have asked to testify to come to the table. We are going to try to get all of your testimony at once.

I would ask all of you to try to summarize your statements and get to the specific thoughts that you would like to have the committee hear.

Would each of you, before you testify, state your name and business?

TESTIMONY OF GEORGE SHUTRUMP, PRESIDENT, CHAS. SHUTRUMP & SONS, GENERAL CONTRACTORS, ON BEHALF OF THE BUILDERS ASSOCIATION OF EASTERN OHIO AND WESTERN PENNSYLVANIA

Mr. SHUTRUMP. Mr. Chairman, I am George Shutrump, president of a general contracting firm which has worked in the area for the past 70 years.

I am here today to represent the Builders Association of Eastern Ohio and Western Pennsylvania, which is a construction trade association of over 300 employers servicing the commercial and industrial construction markets in Mahoning, Trumbull, and Columbiana Counties, Ohio, and Lawrence and Mercer Counties, Pa.

There is one single word that best describes the effect of the high cost of borrowing on the construction and it is devastating. The user of construction services, our customers, must borrow money to build, expand, or modernize their facilities. The high interest rates have caused long-term mortgage financing to be crowded out of the money markets, forcing our customers to either cancel their plans to build or expand or delay them until interest rates decline. As the number of construction projects declines, the number of contractors bidding each project increases. This results in lower bids, usually below estimate, and consequently lower contractor profits.

At the same time contractors must borrow money to operate their business, which is extremely cash intensive. It requires approximately 10 percent of the contract price, in instant cash, to start a job and keep it going for 60 to 90 days, until a stable cash flow is generated from that job.

In periods of little or no cash flow money must be borrowed to make equipment payments, service current debt and meet normal

overhead expense. In any case, the construction industry remains chronically depressed so long as the interest rates remain high, and being the largest industry in the country, nearly every community in the country is similarly affected.

Besides depressing the construction market, high interest rates have helped erode the buying power of construction workers. Since fewer construction projects also means fewer construction jobs, the unions are determined to make up for the lost time and inflation at the bargaining table. Construction wage settlements reported for 1981 by the Construction Labor Research Council have increased by an average of 11.4 percent. A decline in interest rates would stimulate the construction market and produce more jobs, restoring stability to the pay check of construction tradesmen.

In this five-county area, most all construction union contracts expire on May 1, 1982. That will result in about 25 to 30 new wage settlements next year. If the construction market stays depressed and labor tries to catch up with inflation at the same time, most contractors in this area will not be able to afford a sharp rise in labor costs. Having to borrow operating money at high interest rates will simply put many area contractors out of business or drive them into the nonunion marketplace.

Our own firm has been in this area for the past 70 years. I think that our largest achievement in the past 2 or 3 years is just to stay in business.

To sum up, all segments of the construction industry from customer to contractor, from supplier to labor, are caught in a vicious circle, a vicious circle that will never stop so long as it is being fueled by high interest rates, and will get worse before it gets better.

TESTIMONY OF JOHN W. McAULEY, PRESIDENT, SMALL BUSINESS COMMITTEE, YOUNGSTOWN AREA CHAMBER OF COMMERCE

Mr. McAULEY. My name is John W. McAuley. I welcome this opportunity to appear before this congressional subcommittee hearing on the effects of the current high interest rates on my home improvement business which I started 35 years ago.

Several weeks ago, while flying a kite with my grandchildren on the beach of Westhampton, Long Island, suddenly over the excitement of the beach festivities a shrill piercing cry of help came from the waves. Everyone within the sound of this desperate cry responded immediately in some fashion.

Since then I have often thought how similar the business person today is crying for help caught up in a sea of Government controls, redtape, OSHA regulations, paper work, and now the tidal wave of high interest. Yes, the Government of late has heard our pleas and many long-needed welcome changes have been instituted. But the only relief we get from the high interest dilemma is the assurance that you are aware of the problem and if we can just hold out these high rates will come down.

Most all of my early sales were made on a cash basis.

But to enable people who didn't have the money to obtain, in many cases, an improvement to their home that would return sufficient savings to pay for itself the Government initiated,

through the local banks, FHA low 6-percent interest loans. Needless to say, these insured loans gave a tremendous boost to business. So this Government-sponsored effort was not only good for the small business but equally beneficial to the banks and customers as well.

This is a perfect example of the type of assistance that is needed today, for the current 18-percent interest rate is beyond most people's ability or willingness to pay. I believe it is the main reason my sales volume is down close to 50 percent to what it was in 1979. In order to survive to this point, I have had to dig into cash reserves, reduce inventors, lay off people and cut back everywhere possible. The next step, which is not too far down the road, will be to go 30 to 60 days late on payment to my suppliers and this as you know spells the beginning of the end.

Well, you say, go to the bank and borrow the money, it will only cost you 22 percent; and oh, yes, you will also need to supply sufficient collateral or sign over the deed to your home. It should be possible at this point if a responsible company with a good past fiscal record needs temporary financial assistance to obtain it at a realistic rate without regard to color, minority grouping or the number of points you are willing to give up to qualify.

I don't ask any handout, but just an environment that will enable me to carry on my business. For after all, isn't some type of governmental sponsored action worth saving the jobs of some 30 or 50 people? Isn't it better that they take pride in the fact that they work for what they receive, pay taxes to help support the Government, rather than do nothing and collect unemployment handouts that are breaking the back of our Government?

You say why should the Government be responsible for this assistance, let the private sector do it. But by your own admission, it has been the reckless spending of Government and their need now for loans to pay for past indebtedness that keeps up the high rate. I find this difficult to believe. Here are interest rate charts of 10 percent to 12 percent that were in effect a short time ago when the Government debt was not that much lower than it is now. If the 10 and 12 percent was available back a few years, why isn't it available today? Why do we have to charge the 18 percent?

You recall Congressman Williams some 8 months ago appearing before our Small Business Committee of the Youngstown Area Chamber on this very subject of high interest saying that Washington recognizes our plight and that relief was coming, just hang in there. Well, we are still hanging and as we do you raise the debt ceiling to a trillion dollars.

President Reagan this past week has told us the interest rate won't come down until the Government's need to borrow is reduced. Before the rates went through the roof the Government needed $120,000 a minute just to pay the interest on the debt. At that rate we are going, I'm afraid, Congressman, not many of us will be left hanging when you all get around to doing something constructive to correct the problem.

This hearing is fine. But what we need is action.

Gentlemen, I not only appear here as a local businessman, but as chairman of the Small Business Committee of the Youngstown Area Chamber. I am spokesman for all of small business of the

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valley. This year our executive committee decided to put aside the regular format of "How To * * *" seminars and do what we could to attack the problems that are affecting us, for our very survival is at stake. We sent out some 200 surveys to a select group of business people and the results reinforce this same cry for action.

Of those responding 46 percent said on a scale of 1 to 10 they would rate their business overall pulse at 5 or less. In answer to the question: If things don't improve soon, how long can your company hang on? Fourteen percent said they would be out of business within 12 months and 29 percent they could possibly last 24 months.

In closing, I would refer to a letter I have addressed to Congressman Williams from the Niles, Hubbard, Newton Falls Area Chamber of Commerce saying they have taken a position against the high interest rates now affecting our industry.

They believe that small business is in a survival position. They also say if interest rates don't soon come down many will be out of business, and this valley can no longer afford any further loss of jobs or erosion of the tax base. It is imperative that this message be made known in Washington. It is signed Michael Guerra, president of the Niles Chamber of Commerce.

[Letter referred to above follows:]

NILES AREA CHAMBER OF COMMERCE,
Niles, Ohio, October 2, 1981.

Congressman LYLE WILLIAMS,
U.S. House of Representatives.

DEAR MR. WILLIAMS: The Board of Directors of the Niles Area Chamber of Commerce, in conjunction with the political action committee of the Niles, Youngstown, Hubbard, and the Newton Falls Area Chambers of Commerce, have taken a position on the high interest rates now affecting our country. It is our opinion that the small businesses of the Mahoning Valley are in a survival position because of these high rates. If interest rates are not lowered soon, many of the small businesses in the Mahoning Valley will no longer be able to operate. This Valley cannot afford any additional loss of jobs or further erosion of the tax base.

It is imperative that this message be made known in Washington.

Very truly yours,

MICHAEL R. GUERRA,
President.

Mr. MCAULEY. The problem, as I see it, is not one of getting the problem made known in Washington, but getting them to respond to it with affirmative action.

The cry for help on Westhampton Beach turned out to be a hoax but these cries of help from high interest problems from our local business people and from all over America for that matter are real and should receive immediate governmental attention so the business community can once again be able to operate and through the free enterprise system put Americans back to work and back on top.

Mr. WILLIAMS. Thank you.

[Youngstown Area Chamber of Commerce letter, small business survey, and results, follow:]

YOUNGSTOWN AREA CHAMBER OF COMMERCE,
Youngstown, Ohio, August 14, 1981.

DEAR SMALL BUSINESS PERSON: The executive council of the Small Business Committee of the Youngstown Area Chamber of Commerce is of the opinion we should exert our efforts at the present time to attack the problems that are affecting us as small business operators. We solicit your immediate response to the enclosed ques-

tions, so that the information can be collectively analyzed and be presented by our executive committee through Congressman Lyle Williams to David Stockman. He is President Reagans' Budget Director, and will be in town on August 30, just two weeks away.

If you feel there are serious problems on your business horizon, now is your opportunity to let your concerns be known. If however, the general economic conditions haven't adversely affected your business, we would appreciate your comments as well.

Most cordially,

JOHN W. MCAULEY,
Chairman, Small Business Committee.

THE YOUNGSTOWN AREA CHAMBER OF COMMERCE

SMALL BUSINESS SURVEY

This survey is being sent to a random selection of small businesses, who are members of the Youngstown Area Chamber of Commerce. Please complete today and return immediately.

1. On a scale of 1 to 10, how would you rate business in 1981? _____
   ...for the last 3 months in 1981? _____

2. Sales volume this year was up ☐ or down ☐ by ___% compared to 1980.
   Sales volume last year was up ☐ or down ☐ by ___% compared to 1979.

   Profit this year was up ☐ or down ☐ compared to 1980.
   Profit last year was up ☐ or down ☐ compared to 1979.

3. To what do you attribute the cause of the above figures?

4. What internal changes have you attempted to reverse the trend?

5. How do you view the immediate possibilities for your business?

6. What changes do you feel are needed to improve your Company's position?

7. If things don't improve soon, how long can you "hang-on"? _____months

8. Are you experiencing cash flow-problems? Yes ___ No ___

9. Have you needed to borrow any short-term money this year? Yes___ No___
   If yes, what interest percent did you have to pay? _____%

10. This year, how many new people have you hired? _____ How many less employees do you have from a year ago? _____

11. Additional Comments:

_____

Signature (Optional)

THE YOUNGSTOWN AREA CHAMBER OF COMMERCE

SMALL BUSINESS COMMITTEE SURVEY RESULTS
(compiled on returns as of August 27, 1981)

SMALL BUSINESS SURVEY

Two-hundred randomly selected Chamber Small Businesses were recently surveyed for the purpose of determining current business conditions, as well as identifying problems, if any, which are affecting operations. Results were to be presented through Congressman Lyle Williams to David Stockman, President Reagan's Budget Director, when he was in Youngstown on August 30. The survey will also serve as resource for further Committee work. At press time, we have had a 30% return.

Results indicated that on a scale of 1 to 10, eighty percent of respondants rated business in 1981 between 3 and 8, with seventy-seven percent stating business the last three months of 1981 better or as good as business for all of 1981. Very slight gains in sales volume and profit is indicated in 1981 over 1980; however, increased sales volume did not always result in increased profit.

High interest rates and lack of construction were given as major causes of business downtown, while up-turns were credited to greater sales effort and harder work. The most frequent internal changes that business has made include decreasing personnel, gaining better control over expenses, expanding market areas, reducing inventory, and in some cases, increasing personnel.

Most frequently cited changes that are needed to improve conditions included lower interest rates, improvement on general economic conditions (more employment), and better management-labor relations. Twenty-five percent of the 34 answering question 7 indicates that they could "hang-on" for one to twenty-four months. Responses on businesses experiencing cash flow problems were eveningly divided. Of the 25 businesses which had to borrow short-term money, interest rates ranged from 10% (personal loan) to a high of 25 percent.

TABULATED RETURNS

1. On a scale of 1 to 10, how would you rate business in 1981?

Responses:

1 - 1	8 - 12
2 - 2	9 - 2
3 - 10	10 - 1
4 - 5	OK - 1
5 - 11	FAIR - 1
6 - 6	GOOD - 1
7 - 7	UP 5% - 1
	SAME AS'80 - 1

(OVER)

On a scale of 1 to 10, how would you rate business for the last 3 months of 1981?

Responses:

1 - 0	
2 - 2	8 - 8
3 - 5	9 - 6
4 - 10	10 - 3
5 - 14	GOOD - 2
6 - 4	FAIR - 1
7 - 4	UP 7% - 1
SAME AS 1st 9 MONTHS - 1	

- Number of responses indicating that business in 1981 overall was better then during the last three months of 1981 - 14.
- Number of responses indicating that business the last three months of 1981 was better than for all of 1981 - 26.
- Number of responses indicating no change in level of business - 18.

2. Sales Volume this year was up/down by _% compared to 1980?

Responses:

Volume Up	Volume Down
0 - 15% - 15	0 - 15% - 12
16 - 30% - 4	16 - 30% - 6
31 - 45% - 1	31 - 45% - 2
46 - 60% - 2	46 - 60% - 5
61 - 70% - 2	61 - 70% - 0
UP - no % given - 4	
Even - 3	

Sales Volume last year was up/down by _% compared to 1979?

Responses:

Volume Up	Volume Down
0 - 15% - 12	0 - 15% - 9
16 - 30% - 6	16 - 30% - 10
31 - 45% - 0	31 - 45% - 4
46 - 60% - 1	46 - 60% - 1
61 - 70% - 0	61 - 70% - 0
UP - no % given - 5	
EVEN - 2	

Profit this year was up/down compared to 1980?

Responses:

Profit Up 24
Profit Down - 26
Profit Even - 3

Profit last year was up/down compared to 1979?

Responses:

Profit Up - 21
Profit Down - 30
Profit Even - 1

3. What causes affected figures in item 2?

Responses:

UP-TURN		DOWN-TURN	
Greater Effect	- 7	High Mortgage & Interest Rates	-17
Aggressive Sales Effort	- 4	Lack of Construction	- 7
New Products	- 2	Recession	- 4
Expanded Territory	- 3	Mill Closings	- 3
Increased Volume	- 2	Drop In Sales	- 2
Maturity of Organization	- 1	Federal "Tight Money"	- 2
Greater Share of Market	- 1	Unemployment	- 2
Local Economic Up-Turn	- 1	Slowdown Or No Capital Investment	- 2
Company Growth	- 1	National Economic Conditions	- 2
Increased Advertising	- 1	Inflation	- 2
Increased Production/prices	- 1	High Product Prices	- 1
Reduction in Prices	- 1	Money Market Investments	- 1
Increased Sales Force	- 1	Soft Economy	- 1
Additional Service & Equipment	- 1	Excessive Competition	- 1
Diversification	- 1	Impact of Imports	- 1
Good Management	- 1	Plant Closings	- 1
New Distribution Methods	- 1	Uncertainty of People	- 1
Incentive Plans	- 1	Too Much Overhead	- 1
Training for Foremen/workers	- 1	Loss of Industries	- 1
Adequate Capitalization	- 1	Financial Condition of Mahoning County	- 1
		Termination of Employment Benefits	- 1

4. Internal changes attempted to reverse down-turn?

Responses:

Decrease Personnel	- 12	Eliminated Waste	- 2
Better Control Over Expenses	- 11	Increased Advertising	- 2
Reduced Inventory	- 7	Diversification	- 2
Increased Personnel	- 6	Shortened Work Week	- 2
Expanded Markets	- 5	More Efficiencies	- 1
Increased Production	- 4	Product Improvement	- 1
Greater Sales Effort	- 4	Expanded Sales Training	- 1
Cut Capital Improvement	- 3	Greater Sales Production	- 2
Lowered Prices	- 3	Tighter Operations	- 1
Better Service	- 2	Intensified Collection Procedures	- 1
Cut Labor Costs	- 2	Improved Productivity w/ New Machinery	- 1

(OVER)

5. How do you view the immediate possibilities for your business?

Responses:

Excellent	- 3	Poor	- 8
Good	- 14	No Change	- 7
Average	- 2	Improving	- 8
Fair	- 11	Uncertain	- 2

6. What changes are needed to improve your company's position?

Responses:

Lower Interest Rates	- 22	Increased Facilities	- 2
Improved Local Economic Conditions	- 5	More Advertising	- 1
		Increased Personnel	- 1
Better Management/labor Relations	- 5	Less Government Spending	- 1
		Leave Area	- 1
Reduction In Taxes	- 3	Better Planning	- 1
Increased Employment	- 3	Intelligent Local Government	- 1
More Business Volume	- 3	Better Depreciation Schedule	- 1
New Construction	- 2	Revised Pricing Practice of Major Companies	- 1
Expanded Markets	- 2		

7. If conditions don't improve, how long can you "hang on"?

Responses:

1-6 months	- 5	No Limit	- 1
7-12 months	- 4	Unknown	- 2
13-18 months	- 4	Indefinitely	- 2
19-24 months	- 4	Not Concerned	- 3
25-30 months	- 0	No Problem	- 3
31-36 months	- 4	A Long Time	- 2

8. Are you experiencing cash flow problems?

Responses:

Yes	- 29
Some	- 1
No	- 29

9. Have you needed to borrow short-term money this year?

Responses:

Yes	- 25
No	- 35

If yes, percent of interest paid?

Responses:

10%	- 1	21%	- 2
14%	- 1	21½%	- 2
15%	- 1	21 3/4%	- 1
16½%	- 1	22%	- 3
18%	- 3	22½%	- 1
19%	- 1	23%	- 1
19½%	- 1	25%	- 1
20%	- 2	Prime + ½%	- 1
20½%	- 1	Prime + 2%	- 1

10. How many new people have you hired this year?

Responses:	Employees Hired	Firms
	1	3
	2	6
	3	9
	4	1
	5	2
	6	1
	7	2
	8	0
	9	0
	10	4
	40	1

How many less employees do you have now than a year ago?

Responses:	Employees Fewer	Firms	Employees Fewer	Firms
	1	1	10	2
	2	10	15	1
	3	1	20	1
	4	3	30	1
	5	2	35	1
	6	3	40	1
	7	1	50	1
	8	0	130	1
	9	1	10%	1

TESTIMONY OF WALTER ROSHETSKY, JR., EXECUTIVE DIRECTOR, HOME BUILDERS ASSOCIATION OF MAHONING VALLEY

Mr. ROSHETSKY. I am Walter Roshetsky, executive director of the Home Builders Association of Mahoning Valley, which represents the residential construction industry in Mahoning, Trumbull, and Columbiana Counties. We appreciate you scheduling this hearing.

It is quite ironic that today is the eve of the second anniversary of the Federal Reserve action which has brought builders and other small businessmen to their knees.

Housing has a very significant impact on the national economy. Housing production has a powerful ripple effect through the economy creating jobs, stimulating sales and demand for additional goods and services provided by both large corporations and small businessmen. And our local builders are all small businessmen.

Since the Federal Reserve Board undertook its tight money policy on October 6, 1979, housing construction has come to almost a complete standstill.

In 1978, the Mahoning Valley builders constructed 838 new houses. In 1980, 332. For the first half of 1981, housing starts are 10 percent below those for the same time period in 1980.

As long as interest rates remain high, this downward trend will continue.

During this past August, our association staged its first new home show in over 13 years; 12 independent small builders constructed homes which were displayed to the public. In only 8 days, 13,000 people attended this show. If we can sell just 10 percent of these people, there would be approximately 1,000 more homes built than all of last year, and an equal amount to the best years we had during the seventies. The demand is there. But so are the monthly payments.

High interest rates have also created an undue hardship on area builders and suppliers who also have to borrow at prime rate or in excess of prime rate.

Throughout the past year, we have heard that we are heading for a recession. Well, gentlemen, builders and suppliers in this area have been in a recession for many months. Again, if this trend continues, business failures will rise and the smallest and least capitalized firms are the ones that are most likely to go under, again, the small businessman.

The administration's programs to bring down interest rates and stimulate investment are a step in the right direction. I just hope that our builders can hang on until they take effect in this area.

In the long run, they will bring down interest rates and have a positive impact on our economy. But we must not stop there. We ask Congress to reduce the Federal deficit for fiscal 1982 below the projected $42 billion and balance the budget by fiscal 1984. We recognize this will require substantial reductions in defense expenditures, as well as nondefense expenditures and entitlement programs, and even advocate the elimination of the tax cuts or the postponment of their enactment. The builders will do their part in strengthening the economy which in the long run will remove the Federal Government from the credit markets.

However, as one of my members states, the builders do not want to be the kamikazies in the fight against inflation.

In addition, we seek the support of Congress to call upon the Federal Reserve Board to stimulate policies that will allow money supply to grow at the upper ends of the ranges of the Federal monetary targets at the rate that will accommodate economic growth and stability.

Also we would like to see an appointment of a small businessman to the Federal Reserve Board, a nonbanker if possible. Vice Chairman Schultz's term ends next year. Consideration would be greatly appreciated.

The opportunity for home ownership promotes stability and a sense of well-being for the American family. Decent housing allows for privacy and a sense of pride that accompanies ownership of property.

The most important aspect of meeting our housing needs may be political. Home ownership and the ability to live in decent and safe housing gives people a chance to become a part of the capitalistic system. Historically, this leads to a strong middle class which reflects political stability and security. The ability to own a home is still a fundamental part of the American dream and the continuing aspiration for almost all people.

Thank you.

TESTIMONY OF JACK O'CONNELL, WESTERN RESERVE BUILDING TRADES

Mr. O'CONNELL. I am Jack O'Connell, with the Western Reserve Building Trades, representing the union aspect of the building industry. I am pinch-hitting here today for our president, Bill Dryden.

Congressman Williams, I heard you earlier ask a question: Has anybody benefited from higher interest rates? I have to say yes. Some of us have. Some of us who years ago moved union pension moneys into financial institutions, we are now benefiting, we are reaping the harvest in our pension funds. But unfortunately, Mr. Chairman, we wear two hats. Wearing the hat as a trustee of a pension fund, we feel good. But when we walk out of the financial institution and go back to the union hall, and the phone call comes in and it says we are laying off today, we are laying off today because we are now representing the invisible man, Mr. Chairman.

Mr. Shutrump is employing the invisible man. The home industry, the small construction industry, is employing again the invisible man. That man is interest rates. It is coming to the point that for every three to four and definitely five men on the job, the payrolls are paying for six. Unfortunately most of our contractors don't have the private money in their own pocket to turn around and meet payroll week in and week out. I wouldn't hesitate to say 98 percent of them have to borrow on a regular basis.

Mr. Chairman, when they borrow, nobody benefits. They are paying the interest rate. The consumer is paying the additional cost. And, Mr. Chairman, I am then representing the invisible man. That is the man that is not on the job, that is drawing the wages of a man who is unemployed and sitting on the bench in the local union halls.

I know you are short of time, Mr. Chairman.

That is all I have to say.

Mr. WILLIAMS. Thank you very much. That was a very thoughtful statement.

TESTIMONY OF MURRAY FIBUS, STEEL CITY CORP.

Mr. FIBUS. Mr. Chairman, my name is Murray Fibus. I have been a small businessman for 54 years.

For the sake of brevity I will forget what I was going to say.

On September 28, 1981, I got a newspaper called the Northern Ohio Business Journal. I was very much surprised to see this one full page ad. It stated:

> Lower loan rates, one more way Central lends a hand to smaller business firms. We understand small business faces different pressures and has different financial needs than larger companies. That is why we have a special lending rate for the smaller business that is pegged a couple of percentage points below what you might expect to pay. It is the best small business loan deal in town. And if your company qualifies for this special rate, the loan can be used for either working capital or longer-term purposes. Small business lending rates are just one more example of our unique commitment to companies your size.
>
> We have always felt smaller privately-held companies need closer, more responsive attention from the bank. So we have responded with a group of innovative, seasoned, professional bankers led by Terry Dunkle who have one over-riding objective, to provide the attention, expertise, commitment, and financial assistance you need to thrive in all economic conditions.

This is written by Central Bank of Cleveland.

Now, if you want to find out what they have to offer, fine. But I am sure that if you go to your local bank and tell them about this, maybe they will look into it and help you out.

Thank you very much.

Mr. WILLIAMS. Thank you very much. That is very interesting.

TESTIMONY OF ARDEL MORGAN, PRESIDENT, MORGAN LUMBER

Mr. MORGAN. Mr. Chairman, I am Ardel Morgan of Morgan Lumber.

In 1978 and 1979, in our relatively small lumber business, we invested about $100,000 in expansion of buildings, offices, as well as installed in addition to this a computer. We got it done just about the time, February 1980, when the industry was hard hit; nationwide lumber went down drastically. It left us with a high cost in inventory. We immediately had to cut it back down to be competitive. We took an out-of-pocket loss of about $75,000 which is not much for maybe General Motors, but it is a lot for a small corporation.

In 1980, we ended up about 33 percent less total sales, about 75 percent less in housing sales, new housing.

I wonder what those figures would have reflected in the real estate graph there had they said "new housing sales" let alone total housing sales.

In 1981, our total sales are a little better. They are off 26 percent. Housing is probably off nearer 85 percent.

Probably one of the worst things that has happened throughout the country and locally is like in Potlach, Idaho. I believe that was in Newsweek. The lumber mill closed down and resulted in disaster for that community.

In our small company, we employed about 50 employees. We have now about 34 employees. That means if it were an employment rate, it would be about 30 percent.

So that is our trouble, certainly, the same as everybody else has.

One thing I do feel, the All-Savers Certificate, which Chairman Luken says he is for, I agree with that. But I think it could have been thought out a little more—put a cap between the cost of the money and what they are going to loan it out for, and definitely putting it into the housing industry. As I understand it, the probability is that this will even raise the cost of money in some of the savings and loans. This to me is a sad thing on a law that should be good. I think it should be thought out more carefully. If it is a subsidy to this industry, that is fine, temporarily.

I think we should stay with the President's program.

Thank you.

Mr. WILLIAMS. Thank you all very much. I might tell all of you, as I said earlier, all of us are struggling with exactly how to solve the problem. We think we have some type of realistic long-range plan to in fact achieve a balanced budget, which should prevent this from happening again, if we can get a Government that will be responsible as far as its need to borrow.

We all, I think, agree the hearing has indicated, the testimony has indicated from all of you that we do need this type of Government. Unfortunately, in the last 20 years we have not had it.

However, I want to assure you, as I have done before, as Mr. McAuley stated, all of us are struggling with how to get relief for especially the small business community. Your testimony, although we have been restricted because of time—and just to explain that, let me say the House is in session today, when normaly we are not, and there is a vote on the equal voting rights, which is a very important issue, and we have to get back; that vote was supposed to be tomorrow, but they have scheduled it today.

I want to assure all of you that your testimony will be shared by every member of the committee, and it will be helpful.

We do not do this just to come out and listen to everybody and say you have an opportunity to tell us. Frankly, we didn't think it would be a pleasant situation, hearing what has happened to you and your business in the past 1½ years.

Realistically, I would like to say, as well as every Member of Congress, that tomorrow or next week we are going to have that solution. But I cannot say that I will tell you and assure all of you that especially in the Small Business Committee we recognize the impact of it, and that is not news, as Mr. McAuley and others have said. However, we want to be very cautious as we deal with new regulations which in most cases have had a reverse impact on what we wanted to do.

So I guess we are walking on eggs, the same as you are, as we struggle with this problem.

I do thank you all very much, and that includes everyone who testified.

I again assure you that members will read what you have said. And it is the number one issue in the country.

I think we are going to solve the problem hopefully in time for each of you in this room to salvage your business, hopefully in time, more importantly, to provide an interest rate market that will become attractive for the consumer.

A couple of good points were brought up. Possible delay in the tax cut was suggested, as well as continuation of the All-Savers Certificate. And there have been other ideas that we will share.

Mr. Fibus brought up what local groups, the financial community is looking at.

Please feel free to contact the office that we have here to make you perhaps more aware of what is available in both the private sector and the Government sector.

At this time the hearing is adjourned.

[Whereupon at 11:10 a.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

HIGH INTEREST RATES AND THEIR IMPACT ON SMALL BUSINESS

THURSDAY, OCTOBER 8, 1981

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ANTITRUST AND RESTRAINT OF
TRADE ACTIVITIES AFFECTING SMALL BUSINESS,
COMMITTEE ON SMALL BUSINESS,
Omaha, Nebr.

The subcommittee met, pursuant to notice, at 1:30 p.m., in Conference Room F, Nebraska Office Building, Omaha, Nebr., Hon. Hal Daub (acting chairman of the subcommittee) presiding.

OPENING STATEMENT OF ACTING CHAIRMAN DAUB

Mr. DAUB. The subcommittee will come to order.

I want to start off formally by convening this hearing to say to you that the chair to my left would be occupied—and soon will be—by my good friend and colleague, Berkley Bedell, who is the Iowa Sixth District Congressman.

It has been my pleasure to serve with Congressman Bedell on the House Small Business Committee and on this subcommittee which is entitled "Antitrust and Restraint of Trade Activites Affecting Small Business."

Our purpose here today is to listen. Each one of us is aware of the ruinous impact that high interest rates have had on our economy, particularly in recent months. No part of the Nation is immune, and no area of commerce remains unaffected, but I believe we can best understand what the effects of these rates are by listening firsthand to those individuals who must make the hard business decisions on these interest rates.

It is important that we hear exactly what are the economic and social costs.

When Mr. Bedell and I return to Washington, we want to be in a better, more informed, position to explain to our colleagues just what is the price we pay in lost jobs, failed businesses or missed opportunities.

There have been many analyses in recent days that suggest that the economy is showing an unexpected resiliency in dealing with interest rates. I believe that what is happening is that the business people are finding ways to keep their businesses afloat by paring expenses, reducing inventories, delaying expansion or laying off marginal employees.

In some cases, this rescue effort may simply keep their heads above water. Unfortunately, it is a salvage operation conducted at a frightful cost.

I urge each of you to be utterly candid with us. What you say here today will be helpful not only to members of this committee, but also in providing Washington with an opportunity to hear from Main Street America.

I thank each one of you for coming. I look forward to hearing from each of you, as well as reading any additional comments that you may wish to provide for the record.

It is an official hearing. Barry is the court reporter from Kansas City.

I would like to take this opportunity to introduce to each of you—and for the record—Counsel to the Small Business Committee, Ty Marsh, who works for Congressman Luken.

We are happy to have you in Omaha, and hope you enjoy this hearing.

Mr. MARSH. I am glad to be here.

Mr. DAUB. Thank you. Would you want to say anything before we start?

Mr. MARSH. Congressman Luken, who is the chairman of the subcommittee, regrets that he is not able to be here today, but he looks forward to reading the transcript.

We have been having field hearings of the Small Business Committee, because it is the best way to reach the small business community. They often cannot afford to come to Washington, and we feel that we need to come to them. Therefore Congressman Luken is pleased to have this hearing in Omaha, but regrets that he is unable to attend.

Mr. DAUB. I would want to say for the record that our subcommittee chairman, Tom Luken from Ohio, has been most kind in essentially assisting me in the opportunity to set up this hearing so that we can get this kind of information.

The Small Business Committee has been particularly useful under the leadership of our chairman, Parren Mitchell, and our ranking member, Mr. McDade. They have been quite innovative in allowing the committee to go to the field, if you will, instead of asking that everyone who wants to communicate, do so by letter and/or by expensive round trip plane fare and then not know whether anyone is listening or not.

I think that we can send the signal of assurance by the effort that we are making here in addition to what other members of our committees and subcommittees are making across the country at this time.

I appreciate you entering those remarks, and they are, indeed, welcome and appropriate.

Let us start with our first witness. If I could call Mr. Jack Barnhart, who is president of Barnhart Printing, vice-president of the Omaha, Nebr. Chamber of Commerce, and chairman of the Small Business Council, to the witness chair.

Jack, we are not going to swear you in, because we are not going to ask that the testimony you give be the truth, the whole truth, and nothing but the truth. When we are talking about interest rates and that sort of thing, I guess that no one quite knows ultimately whether or not the truth is factual.

The experiences that you can share with us today will be most appropriate, and I can think of no finer leadoff witness for this

formal hearing than you. We look forward to hearing what you have to say.

TESTIMONY OF JACK BARNHART, PRESIDENT, BARNHART PRINTING; VICE PRESIDENT, OMAHA, NEBR. CHAMBER OF COMMERCE; AND CHAIRMAN, SMALL BUSINESS COUNCIL

Mr. BARNHART. Thank you, Congressman Daub.

As you well know, the Small Business Council was formed about 3½ years ago. You were on our committee, and you gave us immeasurable help at the Federal level in working on legislative issues.

For the record, we saw the need about 3 years ago at the chamber of commerce to organize the small business people of the city into a federated forum so that they would have a basis of expression particularly in the political arena, but also in other fields; for example, we help them with their education opportunities to broaden their business experience. We also help when they have individual problems that they need direct help with.

But in this circumstance, since they had very little opportunity to get representation in the political arena, we have taken a very forthright stand, both at the State level and at the Federal level, and we thought people in this area wanted to hear from small business.

A good many of the people—of the 15 from Nebraska—that went to the White House conference with our Small Business Council came out quite well with that proposal.

I cannot say that we are anything but pleased with it, but the issue today is interest rates and what happens.

Comparing the people who borrow nothing to the people who borrow a lot, we see it is all related: The more one borrows, the bigger the problem, obviously.

Of the 1,100 people that we have on our council, we can tell that high interest rates are a very, very serious problem. Some small businesses have absolutely closed up and I would think that it could get worse very fast if the situation does not change in the next few months.

I do not want to get into particular circumstances, because you are going to hear from four or five of our people today. I think that they will give you graphic illustrations of where they fit in and how high interest rates are particularly working to the adverse circumstances of their business. However I would just like to give you the overview and maybe relate it to our operation.

We have recently purchased a very major piece of equipment, about a $200,000 piece. Fortunately, we did not have to borrow too much money in order to purchase it. However, if we had to borrow a lot of money we would have been like everyone else: We would have to sit and wait for something to happen.

So to get the program that has been passed going, it is going to have to take some reduction so that the people can afford to do it.

I just want to thank you and your office, Jay and Jeff, and all the people we have worked with. We have never asked them for anything that we did not get an immediate response to. You have gone out of the way to provide us with information.

When we were in Washington, you could not have been more helpful, so for the Small Business Council and the chamber, we thank you.

I think that is probably enough for me to say. Thank you very much.

Mr. DAUB. All of that is part of my job, and we are glad to do that.

I am pleased particularly that you have taken time from your small business work to come to speak for 1,100 small businesses that affiliate themselves with the chamber and the Small Business Council.

I am curious about a couple of things, if I might ask you a couple questions.

One is, what is the average size of the business that is a member of the Small business Council? How many employees do they have?

Mr. BARNHART. I think of the 3,000 people that belong to the chamber about 2,800 of them are so classified as "small business."

If you think you are small, then you find a place on our council, but I suppose the average size is somewhere under 20.

Mr. DAUB. Under 20?

Mr. BARNHART. Yes; I would think so.

Mr. DAUB. Malcolm Baldridge, our Secretary of Commerce, indicated a week or so ago when he was here in Omaha that over half of those persons in this country employed are employed by businesses who employ less than 20 people.

So you said that things might be tight right now, but if things did not change in the next couple of months, do you mean 2 months, 3 months, 9 months? Can you tell it in those terms? Then they are really going to start to have trouble, if they are not having it already.

Mr. BARNHART. I think that it is all a matter of leverage. The guy that has really borrowed to the hilt has probably just about used up all ways that he can cut. Business is just like all of our lives; it is pretty resilient, but I would expect to see within 3 months, if something does not change, too many businesses that would fail that would not otherwise do so.

Mr. DAUB. Mr. Barnhart, you mean by that that if interest rates do not come down?

Mr. BARNHART. Yes.

Mr. DAUB. Do you have any idea what you think the executive branch, and the Congress should be doing or should try to do. Is there any kind of a mechanism from jawboning to statutory relationships to use on the Federal Reserve? Do you have any particular feelings about what should be done?

Mr. BARNHART. I think that it is just inevitable that they go along with the new cuts in Federal spending. If they do not, the purpose of bringing interest rates down is not going to accomplish anything; the inflationary impact of additional borrowing will have eaten into that.

So, unless we can find cuts at the Federal level to compensate so that we do not increase the deficit any greater than the $40 billion, then lowering them is really not going to help. All of this suffering we have gone through is not really going to accomplish anything, because it is just going to bring back more inflation. I see the

purpose and I understand full well why we have high interest rates, but I also see what it is doing to small business.

I think that my only recommendation is to go along and make some more cuts.

Mr. DAUB. Do you remember from the White House Conference the proposal to recategorize or classify businesses into two tiers?

Mr. BARNHART. Yes.

Mr. DAUB. And by some statutory mechanism, to provide for borrowing rates or interest late rates in a two-tier system * * * that they be allowed some opportunity to borrow somehow at less.

Do you think that the Congress should interfere in that way?

Mr. BARNHART. No; I do not. I think that we have got enough regulation as it is and that just opens the door for hard-to-control circumstances.

Mr. DAUB. Do you have any particular feelings about the Federal Reserve policy at this time?

Mr. BARNHART. I think that they are the only ones that are fighting the battle to try to do something about inflation. They have got to do it all by themselves.

I have empathy for them, and I can appreciate where they are coming from, but it is just that they cannot do it all by themselves. They need the help of the legislature and they have already got the support of the executive.

It is a Government problem. They are the ones that make inflation, and they are the ones that—can show us low interest rates again. But if we have 15- or 20-percent inflation, that really is not doing any great big service to us, either.

Mr. DAUB. Do you think that Wall Street is properly or correctly reacting at this point in time?

You know, we have got the high interest rates, and they have been projecting all sorts of concern.

Mr. BARNHART. Yes.

Mr. DAUB. Do you think that it is over current activities of Congress, or is it over the fear of higher deficits, or is it over a disbelief that the Congress really means business, or that the Federals are bad guys, or what?

Mr. BARNHART. Maybe all of the above.

Mr. DAUB. Keep going.

Mr. BARNHART. Like Mr. Kauffman said, I do not think these things are going to happen. I feel that Congress cannot grapple any further with the problems; they will not make the cuts. It is not what I want to happen, but it is what I foresee will happen.

The easy things have been cut; fine, now, show us real commitment, and at that stage, investments won't be made on the basis of emotion; but they will be made on what is going to happen.

I think that right now the Congress does not know what is going to happen. Wall Street probably is trying to give a message, to show us something.

Mr. DAUB. OK.

Mr. Marsh?

Mr. MARSH. I do not have any questions.

Mr. DAUB. I am going to stay on schedule—and invite you to give us any kind of written information that you would like to be a part

of the Small Business and/or your own personal business as testimony in this record.

Mr. BARNHART. Thank you very much.

Mr. DAUB. Thank you very much for coming.

Let me indicate that we are on time and that we are going to proceed now with the second scheduled and invited witness, Mr. Barry Larson, of Barry Larson Homes.

Thank you for taking time to come, and we are most anxious to learn of your views on this very important subject of interest rates.

If you would introduce yourself, and the record then will speak correctly to your statement.

TESTIMONY OF BARRY LARSON, BARRY LARSON HOMES

Mr. LARSON. My name is Barry Larson. I live at 10939 Hilltop Avenue, Omaha, Nebr.

As you said, I own my own company, Barry Larson Co. I have been president of that company for some 10 years.

I have developed land, built houses, condominiums. In short, I am a homebuilder.

I have prepared my remarks, and I do not often speak from notes, but I have a short period of time to tell a rather lengthy message.

I would like to submit a letter that I wrote to your office on September 19, 1981:

[Letter referred to above follows:]

BARRY LARSON CO.,
Omaha, Nebr., September 9, 1981.

Hon. HAL DAUB,
House of Representatives,
Washington, D.C.

DEAR HAL: This letter is my effort to convey to you some straight talk, There are no house bills to refer to, no political mumbo jumbo. Many companies involved in the homebuilding industry in Omaha, Nebraska are going broke or out of business. It's as simple as that. How do I know this? Simple. My company is one of them!

I've been in the construction industry for over 23 years. Thirteen of those years were in the concrete block business. The last nine years I have owned my own construction company. My son, Kirk, has been with me for the last six years and is vice-president of our company. My daughter, Tammy, has done the bookkeeping and clerical work for almost five years. Her husband, Scott, has worked with us for a year and a half as a carpenter and equipment operator. My son, Mark, has been employed on and off for almost five years while he completed college. This year we have "raw boned" our operation, subcontracting only as necessary. We have done our own framing carpentry, poured our own concrete (yes, the boss as well), laid our sod, done all of our own grading, landscaping and yard work. We've done remodeling, odd jobs, commercial work—anything to stay alive.

What's the point of all of the above explanation of our business? Well, it boils down to simply this. This Friday will be Mark's last day as I must lay him off. Scott will probably be laid off by the end of this month. Tammy will probably not have work here beyond October. Kirk and I will be looking for another source of income by November. And that's not all! One of my good and astute friends in the material supply business is closing his doors within the next two months. Six of our subcontractors have left Omaha for the Sun Belt in an attempt to survive. One of Omaha's oldest and most respected home builders has cut his people to a thirty-two hour week, and will start laying off employees two weeks from now whom he has had for 25 years! One of Omaha's largest material suppliers has cut employment from 300 to 180 people, and they are still cutting. July building permits are down 60.7 percent from last July, 28.2 cumulative change from 1980. And, 1980 was a bad year.

We have sold homes and watched the sales break over the inability of the buyer of our condominium to sell their previous home or apartment building because of

high interest rates. We have figured jobs and watched them canceled because of high interest rates. Our working capital has been depleted and is almost gone due to paying high interest rates on unsold inventory and land. And please don't tell me not to have some inventory and thus not pay the interest. That's like telling the grocer not to stock his shelves and pre-sell groceries.

This country, our democracy, should hold more promise than this to an honest and hardworking American small businessman. I'm angry. But, tell me, to whom do I direct my anger? Hal, please don't waste your valuable time by writing to me that the Feds did this, the DIDC did that, or the Democrats did whatever. Nor that the Arabs did such and such, or that the Congress voted thus and such to do this and that. I read the "Journal", study business and chamber reports and am generally alert to what's happening. I don't need to hear it again. It's old news.

Hal, these are the facts. I cannot tell you my depth of frustration as I watch all that my family and I have worked for slip away. And, we can't do a damn thing about it! Make no mistake. We are survivors and, by God, I'm not giving up! My sole purpose in writing to you is to let you know how it really is for our industry, to articulate what is really happening in the trenches. The whole homebuilding industry is going broke. Hal, I really do know what's going on. It's happening to me! Now!

My best to Cindy and the family.

Sincerely,

BARRY LARSON.

Mr. LARSON. Since I wrote that letter, it is public information that Nebraska's largest home builder is up against the ropes in excess of over $2 million.

Many more builders, suppliers, subcontractors, will not last through the winter.

Unemployment in the construction industry will exceed 20 percent in the first quarter of 1982. Most of the builders in my business in Omaha, Nebr., are not broke; they are going out of business.

Our business is off 90 percent this year. We closed 25 homes in 1980, last year. We closed two homes this year.

We cannot continue at this rate. I have consumed over $50,000 in operating capital in my company. I can't borrow money at 18 and 19 percent and sell houses to people at a 17- to 18-percent interest rate.

I cannot afford any longer to buy down from the 18- to 19-percent level.

The only hope in the building industry today is the buy down. That is what buried the largest home builder in Nebraska. That is what is burying other builders in Nebraska.

The buy down; I have never seen a buyer subsidy program that did not eventually eat the seller alive, and the seller in this case is the home builder.

I have knowledge of builders who have sold $60,000 houses and have bought that loan down $9,000. There simply is not that kind of profit in this industry. The average builder in Omaha, Nebr., works on a 10-percent gross or less. It is not there.

It is the old story of having all of the business and losing money on every sale.

The All-Saver Certificates, make no mistake about that, Congressman, that is a bailout for the savings and loans, and I am sure you know that. It started out as a bailout for the savings and loans.

It was only through legislation, incidentally, introduced by one of our Senators in Nebraska, that the farm industry got included and that banks got a piece of the action.

Seventy-five percent is supposed to go to housing and to agriculture, but it is not going to go to the homeowner. It is available to

the S. & L.'s, and they need help, I agree with it, but it is not going to help us.

There will be no better loans, until interest rates in this country come down.

I have some suggestions.

Mr. DAUB. And you have some time, so go right ahead.

Mr. LARSON. First of all, I think that a concentrated effort should be made to straighten out the arbitrage gap in the mortgage fund law that was passed, a banking law that was passed, affecting the arbitrage.

Obviously, they cannot operate at a 1-percent spread. I have heard anywhere from 1¼ to 1½. That has to be done.

I do not happen to be a builder that deals in Fannie Mae or FHA or any of those things or even the mortgage fund, but then it is the old story of the stack of cards; one thing happens in the real estate industry and it causes two or three other sales down the road. That is the kind of an impetus we need.

We need to support deeper cuts in Government spending; that goes without saying.

I commend your efforts and Members of Congress so far; it has got to go farther.

Unfortunately, the National Association of Home Builders has some suggestions that they put forth. I don't agree with some of them and I don't understand them.

One of them is a deeper cut into the defense spending. That scares me. I do not know the answer to that, but I do not know how many more bells you can ring in reducing the Federal deficit.

I think that the budget needs to be balanced by 1984. You asked a question a moment ago about Wall Street. I am sick and tired of hearing Wall Street. I read the Journal every day. Anybody that is in the building business has got to have enough of a brain to do that sort of thing to stay up on mortgage interest rates and what is happening.

But I am sick and tired of the pessimism on Wall Street and the profit taking in the stocks and bonds and the ups and downs and the Granvilles of our world.

We are real people out here in this small business. I believe Reagan. I believe we can balance the budget in 1984. I am tired of hearing the Wall Street experts tell us that we cannot.

I hope that you monitor the tax cuts. Be sure that Reaganomics is working.

Finally, I would like to speak to the Federal Reserve. I hope that the next time there is a member appointed to the Federal Reserve Board that it is somebody out of private industry.

I hope that it is somebody else that does not come from the esoteric world of academia, who is interested only in facts and figures and books. I hope it is somebody like me who had to lay off their daughter and son-in-law when they were ready to present me with my first grandchild in February of next year. No jobs—the Federal Reserve needs somebody who has been through that sort of thing.

I would like to conclude, that I grew up believing there were certain basic needs for human survival, mainly, food, clothing, and shelter.

I also grew up believing that one of the things that separated us, as Americans, in a democracy, was the American Dream, and part of that dream was the right and the privilege to own his or her own home. Unfortunately, this right is no longer recognized by the Government.

In our march toward collectivism, we have overregulated and virtually destroyed the ability of one of the industries as one of the last bastions of free enterprise, all of this at a time when people in this country still agree that they want to own their home.

Less than 5 percent of the buying public can afford to buy a medium-priced house. You have heard that.

Affordable rental units cannot be built, because of high interest rates. The home building industry as we have known it is dead, not dying, but dead.

The 30-year, fixed-rate loan is virtually a thing of the past. If and when interest rates level off in the 13 to 15 percent range, you will see a new ball game.

We are struggling to stay in the game, our small company. Our industries and others like it need help now, not May of 1982, because that is too late.

I would like to thank you for this opportunity of speaking.

Mr. DAUB. I would like to respond first by saying that all that you have said not only made an impression on me, but will make an impression on this committee. I am moved by your compassion and your concern not so much for your own business, and even your own family, but for what you say about what the industry has been and what it cannot be any longer.

This is the kind of testimony that I wish more of my colleagues could hear. I think it was well prepared and the effort that you have taken is most genuinely appreciated and is deeply felt.

You have offered us four constructive areas to talk about and think about. One is the arbitrage fee, and I agree with you in that regard. There is a bill introduced in Congress now to eliminate that arbitrage fee, that 1 or 1¼ percent. I happen to be a participant in that particular piece of legislation. I hope that it will get some attention soon.

Deeper cuts in Federal spending is the second suggestion you made. You indicated that we should monitor tax cuts, and you talked about the Federal Reserve to some extent.

You suggested a level of interest. How far do you think interest rates are going to have to go down before you, personally, in your own business, would be able to realize revitalized business activity?

Do you have a feeling of what rate that should be?

Mr. LARSON. I feel that once interest rates in this country logically lodge in the area of 13 to 15 percent.

Mr. DAUB. 13 to 15 percent?

Mr. LARSON. We will then see revitalization in home construction.

Mr. DAUB. Is that because you can say from your experience that there are a lot of potential buyers just waiting for those rates to go down?

Mr. LARSON. Yes, sir.

Mr. DAUB. And is there a serious pent-up demand, I mean, a meaningful, positive, pent-up demand right now?

Mr. LARSON. There is an incredible demand.

Mr. DAUB. What kind of house? Will it be the same kind of house?

Mr. LARSON. I think——

Mr. DAUB. Will it be a ranch or a $70,000, or a $50,000, or an $80,000? Will it be three bathrooms and three bedrooms with a two-car garage? Or is it going to be some kind of streamlined house, a different kind of construction?

Mr. LARSON. I think that you are going to see such a change in the industry that you will not recognize it in the next 2 or 3 years.

I think that condominium conversions are going to become the thing in the 1980's, not the sort of peripheral thing right now. Then you can provide some houses to people perhaps at $30,000 to $40,000, something that is unheard of, but they are not going to be houses as we know them.

They are going to be houses as Europeans knew them—"flats", apartments, if you will, for sale. I think we are going to undergo that kind of a drastic change in the industry.

Mr. DAUB. Let me interrupt you just a minute to have my colleague join us, and our minority counsel, who has just arrived by aircraft.

Welcome.

John, you sit down and I will introduce you to everybody. I am glad you are here.

Ladies and gentlemen, let me introduce you to my colleague from the Iowa's Sixth Congressional District, Berkley Bedell, who is the majority of this Small Business Committee, and our minority counsel, John Dalton.

Welcome. We are glad you are here.

Our first witness was Jack Barnhart. He had to testify and leave.

Our second witness is now with us, and may I introduce you to Barry Larson, who is president of Barry Larson Homes, and, without recapping, you will be able to get the testimony.

Please, we were talking about the different kinds of house and the different face that you think you will see in the home building industry through the next 2 or 3 years.

Mr. LARSON. As I said, it is anybody's guess, but the profile of the buyer and what they have to do to be able to buy a house, cannot continue forever. It is breaking the backs of the home builders. It is a bailout situation at best.

The best builders that I know of in Omaha, Nebr., right now are simply trading dollars to stay alive and, as I indicated before, after this winter is over, there is going to be an incredible decimation of businesses in this industry, in Omaha, in Nebraska.

Mr. DAUB. I appreciated your comment with respect to the next time there is a Federal Reserve Board appointment and that maybe somebody like us or you will get appointed to that Board. There is a cosponsorship in legislation in Congress for this type of appointment.

I know that Congressman Weaver and others have bills that indicate that when the next vacancy or two turn out there may be a farmer and a small businessman, or something like that appointed.

I appreciate it. Do you have anything else you would like to add?

Mr. LARSON. Not really. Just thank you again for the ability and the time to be able to appear before this group and to read my testimony about my business.

As I said before, at the end of this letter, we are fighters; we are survivors; somehow we are going to find a way to muddle through this thing, but there are a lot of people that are going to be hurt and the whole complexion of the industry is going to change.

Thank you.

Mr. DAUB. Your concerns are one of the reasons that we are here today and we realize that things have to happen sooner rather than later, so you are going to be a part of helping to move this thing on dead center.

Thank you.

Did you have any questions that you would like to ask?

Mr. BEDELL. No, I certainly don't.

Mr. DAUB. All right; fine.

Thank you very much, Mr. Larson. We appreciate it very much.

Mr. Tom Harvey, Franklin Community Credit Union.

Please sit down. And we are not going to swear you in, because to ask someone to talk about interest rates and to tell the truth, the whole truth, and nothing but the truth might just strain matters a bit for all of us.

We welcome you and the time that you have taken to prepare for us today, and the floor is yours.

Mr. HARVEY. Thank you.

TESTIMONY OF TOM HARVEY, FRANKLIN COMMUNITY CREDIT UNION

Mr. HARVEY. Gentlemen, I would like to just say thanks for the opportunity to speak to you today.

We are the real little guys down in North Omaha. I do not have a lot to say about small businesses, because we do not have a lot of experience with small businesses, but I would like to put my 2 cents' worth in.

The interest rates are, indeed, stifling the life blood of many small businesses in the low income, minority community in which Franklin Credit Union operates.

Our own experience is that in order to compete for depositors we are, this week, paying 14.468 percent on 410,000 share certificates. The rate we charge for loans is 15 percent.

As you can see, this puts us in the position of the proverbial merchant who loses money on every sale, for although we are permitted to charge a higher rate for loans, we have thus far held the line in order to serve our low income members.

We will, therefore, soon be forced to raise our interest rates if we expect to continue to make loans.

Small contractors, retail merchants, enterprises operated by minority business owners who are relatively new to the merchant class are, indeed, hard hit. They are hit not only by the slump in new construction caused by high interest rates, but also by the high cost of money they have to borrow to operate.

Many of our members that do business with us every day are among these people, and it is, indeed, frustrating to them to have had the hope of success in their own enterprise and now to see that

hope destroyed by economic factors which their hard work and ingenuity cannot alter.

We have another group of members hard hit by cuts in Government programs, food stamps, ADC, and SSI programs. Instead of being people who pay their bills and patronize their credit union, they are now coming to us asking us to assist them in their circumstances. We simply do not have the resources to do this.

So I am not suggesting that the way to improve the lot of the small business owner is to cut people programs.

We, at Franklin, are deeply concerned for relief from the burden of the small business operator, the low income minority person, and the unemployed of our community.

Mr. DAUB. Thank you very much. Are you a Federal credit union?

Mr. HARVEY. Yes; we are.

Mr. DAUB. So then you can be a depository for the All-Saver Certificates?

Mr. HARVEY. Yes; we can.

Mr. DAUB. Are you engaged in using that or trying to utilize that?

Mr. HARVEY. Yes, we are offering that.

Mr. DAUB. Have you seen or have you studied it? What is your feeling about it?

Mr. HARVEY. It is our feeling that the All-Savers Certificate is more advantageous to our larger depositors. We do not feel that our average low income welfare mother will benefit.

Mr. DAUB. How about the individual retirement account potential for the credit union?

Mr. HARVEY. We also offer individual retirement accounts.

Again, the people that are on ADC and social security just simply do not have the money to put away.

Mr. DAUB. Your purpose, as I understand it, is a low income credit union with a mission.

Mr. HARVEY. That is right.

Mr. DAUB. You know I understand Franklin's operation——

Mr. HARVEY. I know you do.

Mr. DAUB [continuing]. And its valuable contribution that it makes to the Omaha community. You still need to have money, right?

Mr. HARVEY. That is right.

Mr. DAUB. And you still have got to have money to loan out.

Mr. HARVEY. Right.

Mr. DAUB. So what is the effect of a high interest rate on you, if there is not any savings if somebody—either a big saver or a little saver—does not put money in at 14.468?

Mr. HARVEY. The effect is that we have to go elsewhere to solicit deposits and we are doing that. We are receiving a response from the corporate community and a very gratifying response.

Mr. DAUB. That is not a bad amount to pay for your dividend or your interest on your $10,000 deposit.

Mr. HARVEY. No. That is true.

Mr. DAUB. But you are really pushing it, when you are only bringing in 15; right?

Mr. HARVEY. That is right.

Mr. DAUB. You do not have a spread to work from.

Are there any ideas that you might have that, coupled with the social programmatic activity, might change the opportunity for your credit union to do more than it is doing now?

Mr. HARVEY. It is hard to say. Our major problem, as I say, and as you mentioned, is that we just do not have the margin to operate on and, therefore, we have to solicit grants and, of course, a lot of the grants are drying up now.

Mr. DAUB. Does inflation then become a real key? Do you know?

Mr. HARVEY. To inflation?

Mr. DAUB. To the potential success, the future success of your kind of credit union, different from the normal corporate credit union for its——

Mr. HARVEY. Certainly, inflation is a big problem.

Mr. DAUB. Unemployment, rising unemployment, probably cramps the style.

Mr. HARVEY. That causes people to need our services even more.

Mr. DAUB. And it dries up sources of even small savers and small depositors; right?

Mr. HARVEY. Right.

Mr. DAUB. So where would you land if you had to land on one thing, one message you would like us to have then?

Mr. HARVEY. I think the cutting of the social programs has probably hit the people that we serve harder than anyone else; at least, in our experience, this has been true and that, coupled with the fact that money is expensive, has really hurt some of our people.

Mr. DAUB. Thank you very much.

Mr. BEDELL. How long a period of loans did you make; for what period of time?

Mr. HARVEY. We make loans for up to 5 years.

Mr. BEDELL. Are you caught with the pinch that many lenders are, as interest rates escalate you——

Mr. HARVEY. We are stuck with outstanding loans that are at lower rates; yes.

Mr. BEDELL. You said that you solicit grants?

Mr. HARVEY. Yes.

Mr. BEDELL. I do not understand what you mean by soliciting grants. Are those grants from corporate donors?

Mr. HARVEY. Yes. We have received some Federal grants too.

Mr. DAUB. This is a credit union that serves a low income community as distinguished from a credit union that may be at my former employer so that they go outside of their realm under their charter and they can get contributions by way of grants and deposits to loan out.

Mr. BEDELL. I presume that those grants are going to be more difficult to come by.

Mr. HARVEY. Yes; they certainly are.

Mr. BEDELL. You said that you are going to the corporate sector for money they invest with you?

Mr. HARVEY. For deposits; yes.

Mr. BEDELL. Are those investments made for business purposes, or are they made for social purposes?

Mr. HARVEY. It varies. Some of our corporate depositors are simply depositing some of their business funds and others are depositing social conscience money at lower interest rates.

Mr. DAUB. Which I support and commend, and trust you will continue to go out into the community and beat the bushes for those funds on both scores and then to continue to loan out the money for the very worthwhile purposes that you serve.

Mr. HARVEY. That is our purpose.

Mr. DAUB. We appreciate your taking time and would welcome additional information should you care to provide it to us.

Thank you very much for being part of the record.

Jim Dickinson, Senator Jim Dickinson, welcome. We appreciate you taking time and look forward to your remarks, Senator.

TESTIMONY OF HON. JAMES DICKINSON, A SENATOR IN THE STATE OF NEBRASKA LEGISLATURE

Mr. DICKINSON. Congressman Daub and Congressman Bedell, it is certainly my privilege to be here. It scares me a little to talk to two distinguished gentlemen, each who thinks they have to have their own lawyer, though. [Laughter.]

Mr. BEDELL. You all be very cautious. [Laughter.]

Mr. DAUB. I think that a senior member of his party and a senior member of mine sent these guys to make sure that we didn't have any trouble. [Laughter.]

Mr. BEDELL. In Congress, you will find that we all need a lawyer. [Laughter.]

Mr. DICKINSON. It is a privilege being here. I did not have too much notice of this, and my remarks were prepared this morning by talking to myself locked in the cab of a corn combine, so I don't have much prepared to present to you——

I am Jim Dickinson, for the record. I am a farmer/livestock feeder, living about 20 miles west of here.

The effects of high interest rates with regard to agriculture, are well known as they are with other things.

I did a little mental arithmetic this morning. Corn is about $2.50 a bushel or a little less than that on the market here right now. Land is selling at a minimum in our area, dry land Nebraska, eastern Nebraska land, for about $1,800 an acre, at a minimum of 12-percent interest which some are now paying the Federal land bank which can do nothing but go up.

I believe that turns out to be $216 per acre per year interest.

If you have 100 bushels of corn, which is a pretty fair crop in dry land Nebraska, that is $2.16 per bushel interest charged against that corn.

That does not include, then, the interest or investment in equipment and all of the cash inputs that go into raising that corn. Obviously, for those who must try to start out today or who are leveraged quite highly, as someone mentioned earlier here, they are in real trouble.

Some people are established and have some equity in their business, and are not leveraged to the limit. I hope at least, I may be able to survive this traumatic experience that we are going through right now with the relation of prices, interest, inflation, and so forth.

The interest on cattle ranges anywhere from 9 cents to 12 cents per pound of grain for the cattle that we have in the feedlot for the 130 to 140 days.

That, of course, is the difference, in most of the cattle that we have bought, fed, and sold. That is the difference between making a little bit and losing a little bit. That is just what we have been doing for about a year and a half now; losing, not great big losses, but $200,000 or $300,000 on every 150 head of cattle we sell.

The interest on those cattle was $6,000 or $7,000. If we could have cut that in two, we had at least broken even or had a couple of thousand dollars to put in our pocket, so that is what interest is doing to us in agriculture.

And, of course, interest is hurting the younger farmers or those who are leveraged, and sometimes I lose sympathy for those who are leveraged to the limit, because they do have their own volition. When things turn around, they are the first to complain and the first to be in real trouble.

But, certainly, when wanting to get into the business, there is no opportunity at all with these kinds of costs. There is just no way that you can buy land or buy equipment and expect it to pay for itself.

Presently, we are using a combine that is 8 years old. It cost $22,000. It has been over a lot of roads. It really needs replacing before too long. To replace it today with a comparable machine and do the same job. would cost about $65,000.

Now, corn was $3.50 a bushel in 1973 or early 1974, when we bought this machine. Now, it is $2.50 a bushel, and the machine costs three times as much. This is inflation and interest.

That is what agriculture is facing. Agriculture has the largest investment per worker of any industry in the Nation without question, of course.

I suspect that a normal farm operation that has a father and a son or one hired man or perhaps none at all, an operator and part-time help, probably has an investment equal to most of the small businesses that you will be hearing from today that have 10 to 20 employees.

That is about all, Hal. I hope that I am not just speaking for myself, but for agriculture in general.

Mr. DAUB. You paint a picture that says to me, "I am not quite sure how long a farmer in terms of diversified operation can hang on." Is the interest rate a persistent problem in the short term or the long term? Is it causing guys to close down now? Can they survive until next planting season?

Is there something unique about this high interest rate?

Mr. DICKINSON. No.

Mr. DAUB. As it affects farming, as opposed to home building or another segment—auto?

Mr. DICKINSON. No, I don't think so; as far as our surviving until next spring, either interest rates go down or prices go up; I keep hearing rumors from bankers that some farmers will go out of business.

I suspect they will. They may not file bankruptcy, or go broke as such, but they might decide to just throw up their hands now and

have a sale and liquidate what they have and do something else or attempt to do something else.

Taking a long-term approach, I saw that a couple of weeks ago the Federal land bank was offering banks at 16½, that is over 16 percent, 5-year bonds. This tells me that the future is looking of bleak.

Banks have experts that could be wrong, but they hope they are right; projecting that interest is going to be that high. That means that farmland loans will be 18 percent 5 years from now, because they are obligated to pay that on money that far down the road then.

Mr. DAUB. Does the All-Saver Certificate concept, if you are familiar with it, where 70 percent of the funds that come in have to be loaned out, potentially affect the potential interest rates for agriculture?

If they put 14, 15, or 16 percent money to farming operations, would that help?

Mr. DICKINSON. Sure. I guess I am a little foggy on this. Are you telling me that I can then go to my banker and demand that he loan me money at 13 percent because he is borrowing it at 11?

Mr. DAUB. No. It doesn't work that way. We do not expect that it would. However, the potential so stated is that if the funds are there with the requirement, mandated by Congress, they have to be loaned into that sector, if there are enough of those funds available. The competition would then be subsiding as more funds were available so that the rate charged would be diluted.

Mr. DICKINSON. Right. Am I off base when I say that traditionally, interest rates should, on the average, vary naturally, 2 to 3 percent above the inflation rate?

So where is our inflation? It seems to me that that is realistic. We ought to be talking about that.

There are two sides to every coin, you know, and there is another side to this one. When going back to the generation older than me, there aren't too many people left, I am sorry to say.

They saved their money after the depression of the 1930's and worked hard and were very concerned because they are afraid to do anything, except sock it in the bank someplace or to put it in a bond, let's say. They kept those bonds, and this is a personal experience in my family; they saved those bonds for 25 years, until they needed them in their illness or old age.

When they cashed the bonds, they were 2½ times what they paid for them, but the money would only buy half as much as it would have when they bought the bond.

Now, people under similar circumstances are putting money in the bank. I have some friends that have loose cash, and they are putting it out at 15 or 16 percent and they think this is all right. So, as I say, there are two sides to the coin.

But, certainly, it cannot stay this way, if the economy is going to turn around and be stable.

Mr. BEDELL. Senator, if you get $2.50 for your corn, you are doing better than a lot of my farmers are.

Mr. DICKINSON. I doubt if we can get that now, but it has been about that up to now. I think they are probably getting $2.15 to $2.50 for it.

Mr. BEDELL. Yes.

I think that there is something different about farming, and that is that your investment or your dollar of sale is so much greater than it is from or for most other businesses; therefore, interest rates, if you are operating on borrowed capital, are a much more significant factor.

What did you say your land is worth here?

Mr. DICKINSON. I said $1,800, and that is minimum.

Mr. BEDELL. And off that $1,800 land, you get $250 worth of crops.

Mr. DICKINSON. That won't work very long, will it?

Mr. BEDELL. Not counting all of your other investments, so I think that interest rates are going to damage the farmers.

Mr. DAUB. That was kind of what I was trying to see. Does the interest rate find itself uniquely affecting a farmer, even more than a small business when you have got not only surface land but also a note obligation underlying it, that is, equipment, feed, fertilizer——

Mr. DICKINSON. I guess I stated that when I mentioned that the investment per worker is probably many times greater in agriculture than it is in most other businesses.

So if you are borrowing that investment, obviously it is a tremendous burden, and if you borrow some of it, the younger you are, the more you borrow. Hopefully, when you get to my age, you don't have to borrow at all, or you are in real trouble.

Mr. BEDELL. It does not work for all of us. [Laughter.]

Mr. DAUB. Do you think in the long run the State tax revision and the code and/or the depreciation schedules being accelerated for that $65,000 piece of equipment you talked about, is that going to give some assistance to help people trade up and out and buy more machinery? Will it help prevent farmers from selling off a section of land or going to the bank and borrowing to keep it in the family?

Mr. DICKINSON. I think that obviously there is a lot of arithmetic to do when you decide whether you need to buy that $65,000 machine or not. There are some figures involved, and you almost need an accountant to figure out whether or not you ought to do it, but certainly those things will be of help.

Mr. BEDELL. But accelerated depreciation does not help you if you are losing money.

Mr. DICKINSON. No.

Mr. DAUB. Nothing is riding up against that no.

Mr. DICKINSON. That is right. But it might stimulate business a little if business is slow. However, eventually you do go clear out of business.

Mr. DAUB. How do you think the Federal attitude toward the loan systems that are available in the agriculture bill, the Farmers Home Administration, Federal Land Bank, and the intermediate credit bank, ought to be? Do you have any comments along those lines?

Mr. DICKINSON. I guess I am not particularly allayed. I hear lots of comments, and I am sure this is a real difficulty and maybe essentially impossible, but maybe we should have a restricted credit instead of high interest rates to restrict spending; let us have

restricted credit. Let's make the farmer pay 40 percent down on that combine or on that acre of land or on a new refrigerator, on whatever it may be, but not charge him so much interest on the balance that he must borrow.

We have a nation of people who have been encouraged to buy now and pay later, and that has worked for them because of inflation over these years; and that has created some of our problem. The Government spends beyond their means, but they have also taught people to spend beyond their means.

Mr. DAUB. Do you have any other questions?

Mr. BEDELL. No.

Mr. DAUB. Thank you very much, Senator.

Mr. DICKINSON. Thank you.

Mr. DAUB. We appreciate your taking time to be with us. Are you going to go back and pick corn now?

Mr. DICKINSON. I am; sure am. Thanks a lot.

Mr. DAUB. I would like next to introduce to the subcommittee and to those in attendance, Mr. Terry Moore, president of Omaha's Central Labor Union, who I know has a very busy schedule.

We are delighted, Terry, to have you come. State your name, too, because of the formality in the hearing and the record.

We would very much benefit from your input on this big question, this wrenching problem of what high interest rates are doing to our country's economy.

TESTIMONY OF TERRY MOORE, PRESIDENT, AFL-CIO, OMAHA AREA

Mr. MOORE. I am Terry Moore, president of the AFL-CIO in the Omaha area, 3929 Harney Street, suite 3.

It is a pleasure to be here today with the misfortune of the high interest rates that we are feeling in this city, as well as across the country.

I have a small prepared statement that I would like to make and then go into an explanation.

We see as the problem today that interest rates have reached levels that would have seemed unbelievable just a few years ago.

The Federal Reserve Board, acting independently, has decided that the way to break inflation in this country is to squeeze down hard on the money supplied with the result being high interest rates; particularly hard hit are the credit-sensitive sectors of the economy—housing, saving institutions, utilities, automotive industry, municipal governments, farmers, and especially that of small business people.

We feel that there are some solutions and alternatives to the simplistic monetarism of the Federal Reserve. Credit tight policies exist and the concept of these tight allocations should be challenged by banks. They should channel their efforts toward a socialistic type of productive use of industry, social and also house purchasing. The Federal Reserve should veer away from the use of moneys toward silver speculation and gambling casinos.

We go on with the areas of how we think it should be improved, but I think more important than that, is what is happening to us here in Omaha, because we cannot reach across the country since our knowledge is limited to what we are feeling here locally.

So I prepared a few figures for you. Part of these figures had been gathered as of April 27 of this year, and as recently as October 8, today.

I will first start with the figures of today and in a series of areas in the construction trades, since tight money first affects those areas of industry in the building/construction trades, I feel this would have its most impact.

As of today, the steamfitters have a 9-percent unemployment problem. The masonry workers have a 32-percent unemployment problem. The iron workers have a 38-percent unemployment problem. The painters have about an 18-percent problem. The bricklayers have a 12-percent problem. The sheet metal workers have an 18-percent unemployment problem. The electricians have a 31-percent problem—almost the same depth of unemployment that was reached during the Great Depression in this country as far as electricians are concerned.

The carpenters have a 16-percent unemployment problem. The plumbers have a 30-percent unemployment rate and naturally the laborers which are hit first and foremost and hardest have an excess of 36-percent unemployment.

This, itself, only outlines a few of the building trades as of October 8. And back during the last week in April of this year the steamfitters, and following the same line, the same alphabetical order, they follow the same line of 15 percent, 40 percent, 36 percent, 12 percent, 20 percent, 17 percent, 33 percent, 21 percent, and 33 percent.

As you can see, in some areas they have improved a small area, and in others unemployment has widened.

This will probably increase unemployment in the months of December through March. Unemployment will probably be in some of these areas in excess of 48 percent unemployment in the building trades.

We are looking at a terrible dilemma in this city as far as constructions. Most of the people that have lived here and have in the past had the pleasure of working here no longer do so. Their families are still living here, but they are traveling up to 1,000 to 2,000 miles to other cities to where there is somewhat of a boom with construction. They are not witnessing that here locally.

However, even that is starting to cut back, because of tight money in other cities such as Denver, Colo., Houston, Tex.; and so forth, because of the tight money, high interest rates. That is starting to roll back.

We feel that without the efforts of a looser money market, small business cannot start to gear up the economy, and that is what we are talking about; starting the housing industry, and we feel that is very important.

There is room to enlarge the housing industry, especially in low income housing. We have made some suggestions to the U.S. House of Representatives, as you may know, Congressman, of using union pension money to have Federal guarantees channeling those moneys into the housing industry.

We feel that would help raise the credit market as far as investor speculation would be concerned. The guarantee of the dollar that is presently in the market would generate some housing and

would help these individuals, the very same individuals in small business that are now going broke.

They are, at this point, going broke. As they go broke, we go out of business. The concept of people figuring that business and labor are always against each other is erroneous. We are together.

Business and labor must walk together if we are to profit together. Without someone running the business, we have no jobs and we realize that.

We always guarantee the right to be adversaries on different sides of the table when it comes to the time of negotiation, but we are very concerned about the outlook of business in this country today.

Mr. DAUB. I not only appreciate your remarks and taking time to come, but I really want to indicate to you that I am personally concerned about the figures that you just related as comparison.

Do you know what that would amount to in terms of people?

Mr. MOORE. In people?

Mr. DAUB. Just an estimate of the numbers that are not working right now.

Mr. MOORE. Probably in the building/construction trades at this present time the rate is probably around 2,000 workers.

Mr. DAUB. About 2,000 heads of households in most cases.

Mr. MOORE. Right.

Mr. DAUB. And they are unemployed?

Mr. MOORE. Unemployed.

We are not talking about individuals who are under-employed; and because of that feel for the market they are still working in one capacity or another.

We are talking about people that are laid off. We are not talking about people that are working maybe 1 or 2 days a week.

There are a lot of people at this time who are working 1 or 2 days a week. As a matter of fact, most people are working about 3 to 4 days a week. They are not even working the full 40 hours.

I did not even touch into the area of industry. Western Electric has cut back; most of your plants and your industries are cutting back. It is because of the effect that is being felt throughout the economy.

Industry is off tremendously. I only brought to you today figures of data of the building/construction trades.

Mr. DAUB. I appreciate that. I had two questions for you, Terry.

One was the opportunity to allow pension funds be used by way of investment, not by way of a loan, which you stated, as an exchange system.

Mr. MOORE. Right.

Mr. DAUB. By way of an investment in the housing market—and I wonder if your members, have had any interplay with this idea. Where is your position on this idea now?

Mr. MOORE. Our members are extremely interested in using those funds to better the economy and at the same time help themselves.

We have consulted with them. We have met and we are meeting with developers at this time, but that is a very slow rate of trying to approach the entire economy. The only way to do that is through House action.

Mr. DAUB. I would so welcome it. We would welcome it if you could provide information in that regard because I would like to ask you to look at high interest rates, the crushing cost of money, what that might be doing to your pension plans, too, right at the time when we could use that money in the construction trades especially and, yet, find out that the funds are being placed in jeopardy because managing your portfolio is or has now become difficult in view of the stock and bond market.

I am wondering now if that might lend even more uncertainty to the very solid pension programing that the organized labor has developed in the last decade.

Mr. MOORE. We feel that there is room where we can invest and speculate with a portion of that money, and it is part of an obligation of the free trade union movement in this country to guarantee a higher standard of living for its members.

We would enjoy loaning some of that money back to them at very low interest rates in order to stimulate the industry and at the same time create more jobs.

Mr. DAUB. I sure think that it is an idea well worth considering, and it is appreciated.

Congressman, do you have a question?

Mr. BEDELL. Yes.

Where are those pension funds invested now?

Mr. MOORE. They are just about wherever you want to find them. They are all over the board at this time. They are in the different buildings, different corporations. They are speculated into different, blue chip areas mainly, through investment corporations that are acceptable to ERISA and to the Federal Government. Naturally, they are or we are, under heavy scrutiny of those moneys properly managed by the trustees.

Mr. BEDELL. Of the unemployed, you said that there are approximately 2,000?

Mr. MOORE. Yes.

Mr. BEDELL. Roughly, how does that break down? They are getting money from somewhere to support their families. Where is that money coming from?

Mr. MOORE. The unemployed——

Mr. BEDELL. Some of them you said are going to other areas to get jobs. I presume some of them are still here.

Mr. MOORE. Congressman, we have no idea of where they are making their other moneys. We only know that they were on the charts and they were on the book as being union members, and they are not working at this time.

If there is a second earner in the house, be it the wife or if there are a couple of children working, bringing in money to help pay the bills, we have no knowledge of that information.

The only knowledge that we have at this time is that the individual is not working in his or her trade, and he is or she is unemployed.

Mr. BEDELL. I guess what I really want to know is, Are they drawing from the Federal insurance unemployment benefits?

Mr. MOORE. Very few of these people will draw unemployment——

Mr. BEDELL. Unemployment compensation or food stamps?

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Mr. MOORE [continuing]. Or food stamps.

Most of them, because of the situation and the nature of their work are holding a reserve. They are held with a liability in the first place, because most employers will not hire them simply because they know that if a contractor calls them, even if it is for 2 days of work, the man is going to go to work there.

He has his pension benefits and his health benefits geared into that contractor. If he turns down a job, he goes to the bottom of the call list, which means that he might not seek work for 12 months if he turns down a call.

Otherwise, if I am a contractor and you are working for me, and you have been unemployed, and I want you back to work, then I call you to come to work, and you refuse me, you will go to the bottom of the call list.

So in order to void that, when I call you, even if it is for a few or 2 days or maybe 4 hours, you are going to come in and go to work for me.

Most people know that, so they are very reluctant to hire them into their industry because they know that they are not going to be around very long.

They do do side jobs sometimes, and maybe cut grass, or haul trash, something of that nature—in order to try to make ends meet, but it seems at this time there is not much of that work around because of the large unemployment in all of the markets.

Mr. BEDELL. We are short on time. I understand what you are saying, but I do not understand what it means yet.

Are you saying that because they will take work whenever it is available, that they automatically go to the bottom of the stack, and then how does that keep them off Federal welfare? Is that what you are saying?

Mr. MOORE. They are going to have to make a decision, naturally, because of the restrictions that are on such things as food stamps and unemployment and things of that nature. They cannot earn a certain amount of money.

Mr. BEDELL. Sure.

Mr. MOORE. So if they work, they are going to earn the minimum amount of money and disqualify themselves for food stamps or unemployment.

Mr. BEDELL. So you are saying those unemployed are likely to have a job now and maybe another one in a month and another different one in a month. Is that what you are saying?

Mr. MOORE. That is true.

Mr. DAUB. What is the total trade list, 2,000 unemployed out of how many?

Mr. MOORE. I would say out of seven.

Mr. DAUB. Out of 7,000?

Mr. MOORE. Out of seven; yes.

Mr. DAUB. So you would have two over seven, or two over eight, or one-fourth, or 25 percent, maybe; or 30?

Mr. MOORE. In that area; 25.

Mr. DAUB. In that range?

Mr. MOORE. Yes.

Mr. DAUB. Thirty percent——

Mr. MOORE. Of the overall.

Mr. DAUB. Of your skilled journeymen; is this including apprentice work, too?

Mr. MOORE. This does not include apprentice work; no. It includes skilled people except for in one area of laborers.

Mr. DAUB. Laborers.

Mr. MOORE. Which is unskilled.

Mr. DAUB. Unskilled.

Mr. MOORE. To a degree. Now, there is a skilled area there. Naturally, when you get into the area of supply and things of that nature, you cannot take a green person into that. It has to take someone who has been around a while.

Mr. DAUB. I want you to know that Congress is very sensitive. We probably are, as you pointed out, in one of these credit-sensitive areas right now, because everybody is looking, and saying, "What are we going to do?", and part of your testimony today is certainly going to be enlightening to our leadership.

I appreciate particularly the opportunity to look at the very positive willingness of the AFL-CIO, particularly building trades, to guarantee a better standard of living for their membership, by being willing to offer some of the security of their pension plan, and put it back in the marketplace to work for jobs.

That is appreciated, Terry. Thank you for coming today.

Mr. MOORE. Thank you.

Mr. DAUB. John Hoie, Commercial Federal Savings & Loan.

How are you?

Mr. HOIE. Just fine.

Mr. DAUB. Welcome.

We are, as a matter of fact, wanting to move along, so go ahead.

Mr. HOIE. OK.

TESTIMONY OF JOHN HOIE, COMMERCIAL FEDERAL SAVINGS & LOAN

Mr. HOIE. My name is John Hoie.

I am with Commercial Federal Savings & Loan.

I have prepared a statement, but unfortunately I was a little short of time like Mr. Dickinson and it came across a little stilted so I think that I will just try it off the top of my head.

Anybody who can read, I am sure, has come across in the Wall Street Journal or around here in the World Herald in the last 6 months a number of articles on the plight of savings and loans.

I think perhaps they exaggerate slightly, but there is no question that high interest rates have hurt us.

The basic cause for this, and I think it is part of the structure that was built into the savings and loans to allow them to service home buyers, is or can be summarized in one statement—that we borrow short and lend long.

That is not a problem, if rates are fairly stable, but if rates skyrocket that puts us in a tremendous squeeze.

What happens today, for instance, is that with the maturity on our savings of less than a year, we might take in a $50,000 money market certificate at 6 months perhaps at 9 percent, if you go back a couple of years and make a loan at 11 percent. It looks like a good deal at the time.

In 6 months, when it rolls over, and that certificate is 14 percent and immediately we are under water.

This has been happening on a fairly regular basis over the last couple of years and that has been the source of the losses that the industry has experienced.

It could be argued that we will profit on the way down, but the profits coming down are really diluted. Most of the loans we make are at the lower rates and those loans tend to stay on our books a long time.

The average maturity on our loans is over 12 years now because of the high rates.

We make very few loans at the high rates today, 18 or 19 percent, and when rates drop back down, those loans are going to come off of the books. Nobody in his right mind is going to maintain an 18-percent loan on his house when the market rates are 13 percent.

So we have been caught in a real squeeze and if rates stay where they are, I think that it would take over 5 years at least for the savings and loans to turn profitable.

I don't know if the industry can withstand that sort of variance pressure for that period of time. Regarding suggestions we would have, one would be simply to balance the budget.

I personally do not disagree with the Federal Reserve's approach. I think that we need monetary strength or restraint, but I think that we need fiscal restraint also.

The $60 billion deficit is too much for the credit market to stand.

I would also like to see us change the tax laws. The way they are set up, they simply encourage borrowers and discourage savers.

We have one of the lowest savings rates in the industrialized world and it is no accident, because of the ways our laws are set up.

You have asked about the all savers certificates and there is no question that they help the savings and loans, but quite frankly it is a sop for us and it is not a permanent solution to the housing problem, to cut our losses, it will not help the housing industry, because only a stupid savings and loan is going to lend that money out in home loans.

What happens, because of the temporary nature of legislation, if we were to peg the rate to the all savers certificates, as though we might originate along the 14½ percent based on the 12½-percent all-savers rate, and then in a year, that money rolls over and it is into another money market certificate at 16 or 17 percent.

What we really need is permanent tax-exempt savings of some sort that we can count on as a long-term low-rate source of funds.

Mr. DAUB. Is that where you are coming from?

Mr. HOIE. Yes.

Mr. DAUB. So you say that you think the Fed's policy is correct at this time?

Mr. HOIE. I do not personally have any complaint with it.

In the past, it has accommodated the Treasury, when it had to borrow. If it loosened up now to accommodate the Treasury, I really think that all it would do would be to raise the inflationary expectations and that would probably drop rates even move.

Mr. DAUB. The all savers mandate of having to loan out without two industries, essentially, homebuilding and agriculture, isn't going to cause that influx of funds even though temporarily perceived and not permanent. What will the impact be on homebuilding, in your judgment?

Mr. HOIE. As I imagine you are aware of, there are a number of alternatives that, in effect, can allow savings and loans to get outside of that requirement.

I am personally glad that there are, because I think that it would be ruinous to us to put it out in new loans at low rates.

Now, we certainly have no objection to making those loans at market rates. We are used to borrowing short, lending long; it is just borrowing short and lending long at low rates, below market rates, that would be ruinous to us.

Fannie Mae has a certificate that qualifies for investment, as I am sure you know, with a 1-year maturity which I think a number of savings and loans have used. I think that Freddie Mac offers or has offered the same sort of thing.

Mr. DAUB. What is Commercial Federal Savings & Loan going to do with this new money it can temporarily receive?

Mr. HOIE. I honestly do not know. Most of the loans we are making right now, by the way, are not at 19 or 20 percent. As with most of the savings and loans around here right now, we are offering mostly preferred rate loans to present customers trying to roll over our portfolio so that most of the new loans that we make are in the 14- or 15-percent range.

Mr. DAUB. How about the variable rate mortgage concept, does it help or hurt? Is it a good instrument in wrong economic times?

Mr. HOIE. There is no question it helps for the borrower. If I were in the market for a home right now, I think I would be more inclined to take a variable rate loan at 19 percent than a fixed rate loan at 19 percent, keeping in mind that rates still could go up.

I think it is more likely to go down. For the savings and loans, I think that it is going to be a very valuable instrument. I am glad we have it.

But for right now, because of consumer resistance to it, it has not been much help simply because we do not have great volume of it.

Mr. DAUB. Would it have been good if you would have had it 20 years ago?

Mr. HOIE. If we had had it 20 years ago, we probably would not have the problem today.

Mr. DAUB. Because you would not have such a problem with the 5¼-percent mortgage papers still being on your books?

Mr. HOIE. We have a lot of 7-and 9-percent loans. Those loans are today worth about half of that.

Mr. DAUB. Are you selling any loans?

Mr. HOIE. Selling our loans?

Mr. DAUB. Your loans.

Mr. HOIE. Very few.

Mr. DAUB. Very few.

Mr. HOIE. If you are talking about the old loans now, we might consider it in the future. But somebody would have to do a lot of convincing for me to believe that we can sell a $50,000 loan for $25,000 and make a profit.

Mr. DAUB. It is like selling down, right?

What about the Keogh and the IRA plans as far as your portion of the thrift institution, is concerned, and its outlet for you?

Mr. HOIE. I think that the new legislation is tremendous and I am really happy to see that come through. It is not going to erase. What it will do is give us a longer term source of funds to match up with loans.

Mr. DAUB. What will lower rates?

Mr. HOIE. Tax-exempt savings.

Mr. DAUB. Tax-exempt savings?

Mr. HOIE. Yes.

Mr. DAUB. How do we do that? You say permanent in one respect, but——

Mr. HOIE. What I am saying is the all savers certificate is temporary and anything that is temporary precludes the lenders from relying on it to make long-term loans.

Mr. DAUB. But that has got to be just not for savings and loans, right? It has got to be true across the board.

Mr. HOIE. Anybody that is taking in all savers certificate money.

Mr. DAUB. So you would have been happier if that instrument was good for banks as well as savings and loans, instead of limited just to credit unions and banks or credit unions and savings and loans?

Mr. HOIE. Banks can have it.

Mr. DAUB. But their relationship is one of the commercial side of the market versus the institutional home mortgage requirements that are based upon your institution.

Mr. HOIE. I have no problems with everybody having the same thing, as long as we have the authority to make the sort of loans that can be profitable to us. We cannot originate loans at 15½ percent based on those 12 to 12½ percent all savers certificates.

It is unrealistic to expect rates to come down because of a 1-year certificate.

Mr. DAUB. So would the threshold of exemption be dominated by an instrument; for example, we tied the $1,000 interest free for a lifetime to the all savers certificate?

What if next December, we said that the interest exemption per person is going to be a fixed amount: $1,000 or $4,000 or $2,000, period, and let that be accumulated by way of money markets.

Mr. HOIE. You mean lifetime?

Mr. DAUB. Yes, that kind of thing.

In other words, we tied this to one particular kind of an instrument. We may have dug ourselves a hole, right, if we are either forced to renew it, or take it off but replace it with something else?

Mr. HOIE. That is the other big flaw, making it a one-time exemption of $3,000 per couple, $1,000 per individual.

Mr. DAUB. Make it annual?

Mr. HOIE. An annual sort of thing; I think there does need to be some sort of limit, otherwise people with large amounts of cash could simply squirrel it away and never pay any taxes.

I do believe that the amount could be somewhat large. At today's rates, you can put in about $16,000 to get your annual $2,000 exemption per couple, $1,000 for an individual. That is not a wealthy person by any means. I think you can catch most of the

middle class who are major savers in the country with a somewhat higher exemption and make it annual, not a one-time time.

Mr. DAUB. Do you have any thought on that?

Mr. HOIE. As far as an actual dollar amount?

Mr. DAUB. Yes.

Mr. HOIE. No; I do think it needs to be somewhat more liberal.

Mr. DAUB. $2,000 per person per year?

Mr. HOIE. That would be fine with me.

Mr. DAUB. And how would you limit it? Would that be the only way that you would limit it?

Mr. HOIE. Yes.

Mr. DAUB. An annual and the permanent?

Mr. HOIE. Yes.

Mr. BEDELL. I thought that in the last tax law we cut out the annual interest exemption——

Mr. DAUB. We did. As a matter of fact, it results in a $1.9 billion tax increase and that was in the first year of the exemption.

In other words, with revenue to the Treasury, from the tables that I recall, phasing out continues through 1985. It goes to $100, then to $300, and then to 15 percent of the first $3,000 or $6,000 on a joint 1040, which could be potentially $900 per person. In other words, 15 percent times $3,000 times two people, in a joint return.

So the phase is up from $100 of exemption.

Mr. BEDELL. It can go down to begin with.

Mr. DAUB. And then it phases back in; yes.

Mr. BEDELL. But I guess your feeling is that exemption is a better way to go than the all savers.

Mr. HOIE. Permanent exemption.

Mr. BEDELL. I see. How do you feel about the deduction of interest paid?

Mr. HOIE. Certainly, on consumer short-term borrowing, I have, naturally, since I work for a savings and loan, a tendency to favor the one for interest paid on a home loan.

I think we might want to look at the sorts of purposes for which the money is borrowed and the interest is paid.

I am a little bit puzzled as to why anyone would want to go out and encourage someone to go out and buy $10,000 in stereo equipment and deduct the interest paid on the loan.

Mr. DAUB. Credit card interest generally?

Mr. HOIE. Exactly.

Mr. BEDELL. I was surprised in your statement that if you were a borrower you would rather borrow on a variable rate mortgage.

Mr. HOIE. In today's market.

Mr. BEDELL. It seems to me that if you borrow on a fixed rate mortgage, you are borrowing on a variable rate mortgage if interest rates go down and a fixed rate if they go up, because if interest rates go down, you can refinance with somebody else, or if not with your present lender, and get the lower rates.

You can always get lower rates, but you are protected against higher rates.

Mr. HOIE. With some lenders—I don't believe that we have it on any of our instruments of loans—usually there is a prepayment penalty required to refinance.

Mr. BEDELL. Usually that is comparatively small.

Mr. HOIE. A fee today is 2 percent. If you are talking about a $50,000 loan, it is $1,000 then.

Mr. BEDELL. Yes, but that is not very much if you have got 10 years of loan left. Two percent is two-tenths of 1 percent.

Mr. HOIE. What I am talking about is that I simply do not believe that the economy can withstand 20 percent interest rates on a continuous basis. I believe that over the next 10 or 15 years, the rates will have to be lowered if there is to be economic growth.

Mr. BEDELL. I am not arguing one way or the other, but it just seems to me that fixed rate mortgages are bad for lending institutions.

Mr. HOIE. It could go either way.

Mr. BEDELL. And they are beneficial for borrowers.

Mr. HOIE. In today's market, that is possible.

Mr. BEDELL. I don't want to spend too much time on it, but the borrower is protected on the down side. Protected because he is also protected if it goes down because it can be renegotiated, but the lender is stuck if it goes up.

Mr. HOIE. That is why we have had a lot of resistance, and of course, at times when 7- to 9-percent rates were the thing, obviously, today those fixed rate loans are killing us.

Mr. DAUB. I guess my philosophical bent is that Newton's Law does not apply and in economics, never has, if you really stop to think about it.

Things never seem to come down as much as they go up.

So as a result of that, probably the law ought to have been a variable rate from the beginning; then we never would have had the problem of trying to figure out who is going to pay the subsidy in-between when the market is out of whack like it is now.

But I think my colleague makes a gook point. The fixed rate is good for institutions; the variable rate is good for, especially in a market like this, the borrower, because he would get the chance to go down.

Mr. HOIE. The chance to go down, but——

Mr. DAUB. But he is going to be able to refinance somewhere else.

Mr. HOIE. Sure.

Mr. DAUB. That is the thing to remember. I am not so sure what the ups and downs are of having that device now, but the controller of the currency and the other managers of money now seem to have fairly identical rules on the variable rates; now the banks versus the savings and loans are going to get into a crossfire.

Mr. HOIE. I have not been paying too much attention to what the controller has been doing. I understand that the controller's regulations were much more restricted.

Mr. DAUB. We are worried about that, yes, but it is a problem, because if they get to be, why we have got conflicting sets of signals that are being sent out in the money market.

Mr. HOIE. As long as we, to use the bank's favorite phrase, have a level playing field, I have no complaints. That includes the money funds.

Mr. DAUB. We will hear from the banker right after you are done and so we will see what happens.

I appreciate your taking time and offering a point of view particularly with respect to the permanency of whatever is done, in the level playing field.

Thank you very much. Say "Hi" to Mr. Fitzgerald, too.

Could we have Dick Wardell come forward who is with the Washington County Bank.

I won't swear you in, because we are not sure about how to access the voracity of discussions, be they from farmers or from bankers, as to the truth and the whole truth and nothing but the truth, when it comes to interest rates, so help us all. [Laughter]

Thank you.

TESTIMONY OF DICK WARDELL, VICE PRESIDENT, WASHINGTON COUNTY BANK

Mr. WARDELL. My name is Dick Wardell, vice president of Washington County Bank in Nebraska, Blair County.

My duties there are to administer the agriculture loan portfolio. We have some $15 or $16 million in farm loans outstanding, mainly in Washington County, but also in Douglas and other counties.

Some of the things that I am going to say here are just going to substantiate what Mr. Dickinson said and bring some actual data that proves what he said is true about cost.

As far as interest rates are concerned and the way they affect farmers, there are two reasons that it is very severe at this time.

First of all, it is because the rates are high, but also it is very bad because of the compounding fact of the carrying forward debt caused by operating losses. In other words, you are paying interest on interest as you lose money.

The first page of the data breaks down each enterprise in eastern Nebraska. This data, as you will note on the final page, there is a financial report of the Farm Business Association.

I am not going to go through all of the data, because there is an awful lot there and you will see it later, but in the bottom two lines, I think, of each category, the bottom three lines, I took out the interest per acre and expressed that as interest, as a percentage of the total income and interest cost as a percentage of the expense.

In every case, except cattle feeding, you will notice that these percentages have increased tremendously, not only has the cost of interest gone up but also as a percent of the gross income and the gross expense has gone up.

In the case of soybeans, you will notice that it has gone from just under 5 percent up to 9 percent. Corn has gone from 5 percent, from 6 percent up to 11 percent, doubled in terms of actual figures. Those are actual figures.

The dairy is a little more stable.

Mr. DAUB. That dairy is somewhat better.

Mr. WARDELL. If you look up at the hogs, as a percent of expense, you will notice that we start out in 1977 at 8.7 percent and in 1980 it was 6.8 percent, percent of expense. That is because of the losses involved and this is expressed in per hundred.

In 1979 and 1980, both years, hog farmers have lost money.

Of course, the cattle business has been a disaster from the word go, in 1977, interest expense has gone to 12.4 percent of the gross and it declined to 11 percent and even at higher rates——

Mr. DAUB. It was a greater loss.

Mr. WARDELL. It is a greater loss, so numbers are tricky.

Just another set of figures on the bottom of that page is the family living cost, and more about that later. Just note that in 1980, the average family living cost on any farm was $15,600.

The next page contains some figures that are compiled from the Nebraska data on net farm income, and I won't bore you with all of that, except to point out that the net farm and the gross farm income has been increasing at a rate of 9.7 percent over the last 5 years.

It is interesting to note that if I had gone back 10 years, that figure would have been a lot worse, because in 1975 and 1974, there were big decreases. Those figures are on the next page. You can find them there.

There were decreases on the gross farm income. There were increases in expense at the same time, so that figure would have been worse.

At the same time, expenses are going up at the rate of 14.3 percent average over the last 5 years. It is obvious what that does to the end.

At this time, I would like to ask you to flip over and excuse the scribbling I did on the copy of the Nebraska Crop and Livestock Reporting Service form.

Looking at the Nebraska data in the middle of the page, notice that the gross farm income includes cash receipts, Government payments, nonmoney income and other farm income.

That is how the total is determined and then, of course, you subtract the farm expenses to get the next realized farm income.

Mr. DALTON. Could I interrupt you there just for 1 second?

Mr. WARDELL. Sure.

Mr. DALTON. Could you define for a city boy what nonmoney income is in farming?

Mr. WARDELL. You are right on schedule because that is what I was going to explain.

You will notice that I have a big circle around that figure at the bottom of the page.

Nonmoney income represents increases in inventory, increased value of inventory.

Now, I want to make sure that you understand that the figure is increased value of inventory. What we are saying here is that you might have 100 sows on the farm. Last year, they were $150 or worth $150 a head.

This year, you can say they are worth $250 a head. So this is expressed in dollars, not in actual product.

Going on with that, if you would subtract that bottom figure in 1980, the 267 million from the net of 224 million——

Mr. DAUB. It doesn't work.

Mr. WARDELL [continuing]. You will notice that you had a negative cash farm income in the State of Nebraska last year.

Mr. DAUB. There is an expression that says "That dog won't hunt."

Mr. WARDELL. That is right. [Laughter.]

Now, you can see the problem of lender and farmer. Remember that the farm or the family living expense is a cash required item. That requires cash to live, $15,600; that is cash dollars.

This typical farm, or farmer, and remember this is the total data of all of the Nebraska farms and all. These guys are coming in and saying, I have to borrow money to live.

What I have got is increased value, not cash, they are saying, I have got increased value of assets out there.

I have been taking some new statements, and the crop is coming out; we have got a big crop; we are taking some new statements and the preliminary ones look very bad.

There are losses from 10 to 50 percent in net worth in these farm operators this year.

The dilemma that the farm and the lender both have then is a good news/bad news thing. A guy comes in and he says, well, the good news is that I am not going to leave your institution; the bad news is I can't pay you, and on top of that, I need to borrow from the interest because I have to live.

Now, the lender is in the middle of the savers, people that have their life savings in there and he is an agent for the composite of those depositors.

Now, he is not loaning his money so he has the responsibility to the savers. We have a business that is in trouble, they are losing net worth, they are losing their capital. They come in with a history like this, this is a State average and State income expense sheet. The trend is bad.

It is prudent in the popular turn to the State legislature, is this a prudent asset in your portfolio?

There are some other things that I could go on to state. I will respond to questions.

Mr. DAUB. You paint a picture, Mr. Wardell, for those of us very vitally concerned about the health of the agri-economy.

It is not only vital for Nebraska or Iowa, but it is vital for our country where 3.7 percent of the people are still left out there producing that one thing, it still impacts positively on the balance of trade, of dollar, and has something to do with what productivity there is, at least from really our work force out here.

What is the answer?

You have given us the problem.

Mr. WARDELL. I think definitely that there is going to be an adjustment; there has to be.

Mr. DAUB. How many, you said 90 families here in that regard?

Mr. WARDELL. The data is 90 farms, yes.

[Mr. Wardell submitted the following statistics:]

NEBRASKA GROSS AND NET FARM INCOME
(Millions of Dollars)

	1976	1977	1978	1979	1980	1981*
Realized Gross Farm Income	$4,065.6	$4,297.3	$5,199.3	$6,366.7	$6,505.7	$7,135.2
Change over prior year	-34.9	+231.7	+822.0	+1,167.4	+139.0	+629.5
% Change	-.8%	+5.7%	+19.1%	+22.5%	+2.2%	+9.7%
Farm Production Expenses	$3,670.9	$3,994.4	$4,726.3	$5,749.6	$6,281.0	$7,178.7
Change over prior year	+444.0	+323.5	+731.9	+1,023.3	+531.4	+897.7
% Change	+ 13.8%	+ 8.8%	+18.3%	+ 21.7%	+ 9.2%	+ 14.3%
Realized Net Farm Income	$ 394.7	$ 302.9	$ 473.0	$ 617.1	$ 224.7	$ -43.5
Change over prior year	- 479.0	- 91.8	+ 170.1	+ 144.1	- 392.4	- 268.2
% Change	- 54.8	- 23.3%	+ 56.2%	+ 30.5%	- 63.6%	- 119.4

*Estimated data projected from prior five years

	Acres of Land (1,000's)	Taxes on RE (Millions)	Interest on RE (Millions)	Tax & Interest Cost/A
1975	47.900	171.5	107.4	58.23
1976	47.900	192.5	127.7	66.85
1977	47.800	186.0	152.4	70.79
1978	47.800	198.1	181.9	79.50
1979	47.700	214.8	222.8	91.74

(From NEBRASKA CROP AND LIVESTOCK REPORTING SERVICE, report dated September 8, 1981)

SOYBEANS

	1977	1978	1979	1980
# Farms	31	29	48	38
Yield bu./A	36	36	33	30
Selling price/bu.	$ 5.82	$ 6.19	$ 6.09	$ 7.78
Gross/A	209.36	223.01	200.96	233.37
Total expense/A	159.15	151.58	162.82	187.77
Net Return/A	50.24	71.43	38.14	45.60
Interest/A	7.64	11.27	12.52	16.82
Int. % of income	3.6%	5.1%	6.2%	7.2%
Int. % of expense	4.8%	7.4%	7.7%	9.0%

CORN

	1977	1978	1979	1980
# Forms	19	17	30	22
Yield bu./A	66	100	100	59
Selling price/bu.	$ 2.13	$ 2.01	$ 2.09	$ 3.40
Gross/A	140.33	200.66	209.40	200.75
Total expense/A	153.40	172.74	196.46	199.36
Net Return/A	-13.07	27.92	12.94	1.39
Interest/A	8.88	15.46	19.68	22.20
Int. % of income	6.3%	7.7%	9.4%	11.1%
Int. % of expense	5.8%	8.9%	10.0%	11.1%

DAIRY

	1977	1978	1979	1980
# Farms		8	10	12
Gross Total Income		$ 84,831	$114,609	$116,547
Gross Total Expense		79,687	96,502	124,868
Net Return		5,144	18,107	-8,321
Interest Expense		6,209	8,259	11,946
Interest % of income		7.3%	7.2%	10.2%
Interest % of expense		7.8%	8.6%	9.6%

FINISHING HOGS

	1977	1978	1979	1980
# Farms	5	8	16	11
Income/CWT	$ 31.53	$ 34.58	$ 26.55	$ 34.22
Expense/CWT	27.39	29.38	30.93	35.65
Net/CWT	4.14	5.20	-4.38	-1.43
Interest/CWT	2.39	2.26	2.33	2.44
Interest % of income	7.6%	6.5%	8.8%	7.1%
Interest % of expense	8.7%	7.7%	7.5%	6.8%

CATTLE FEEDING

	1977	1978	1979	1980
# Farms	12	10	27	15
Income/CWT	$ 39.43	$ 64.39	$ 60.31	$ 46.75
Expense/CWT	46.30	53.22	57.74	57.01
Net/CWT	-6.87	11.17	2.57	-10.25
Interest/CWT	5.76	7.75	8.72	6.65
Interest % of income	14.6%	12.0%	14.5%	14.2%
Interest % of expense	12.4%	14.6%	15.1%	11.7%

FAMILY LIVING

	1977	1978	1979	1980
# Farms	28	35	46	90
Total Cost	$12,121	$12,640	$15,677	$15,606

(Data from NEBRASKA FARM BUSINESS, FARM ANALYSIS REPORT, 1980)

CASH RECEIPTS FROM FARM MARKETINGS AND GOVERNMENT PAYMENTS, 1971-1980

YEAR	Cash receipts from farm marketings			Government payments	Cash receipts and government payments
	Crops	Livestock & livestock products	Crops & livestock total		
	Million dollars				
NEBRASKA					
1971	694.9	1,485.6	2,180.5	171.0	2,351.5
1972	840.3	1,981.1	2,821.4	233.3	3,054.7
1973	1,560.1	2,398.2	3,958.3	151.8	4,110.1
1974	1,844.9	2,225.1	4,070.0	21.0	4,091.0
1975	1,705.8	2,153.2	3,859.0	71.7	3,930.7
1976	1,660.5	2,167.4	3,827.9	36.6	3,864.5
1977	1,727.2	2,247.8	3,975.0	92.9	4,067.9
1978	1,595.9	3,087.6	4,683.4	268.6	4,952.0
1979	2,034.5	3,884.0	5,918.5	132.7	6,051.2
1980	2,504.4	3,570.3	6,074.7	82.9	6,157.6
UNITED STATES					
1971	22,276	30,583	52,859	3,145	56,004
1972	25,520	35,670	61,190	3,961	65,151
1973	41,132	45,936	87,068	2,607	89,675
1974	51,090	41,359	92,449	530	92,980
1975	45,150	43,059	88,209	807	89,016
1976	48,668	46,112	94,780	734	95,514
1977	48,650	47,639	95,289	1,819	97,108
1978	53,711	59,213	112,924	3,030	115,954
1979	63,394	68,522	131,916	1,375	133,291
1980	69,026	67,405	136,431	1,286	137,717

GROSS AND NET FARM INCOME, 1971-1980

YEAR	Realized gross farm income					Farm production expenses	Realized net farm income	Realized income per farm	
	Cash receipts farm marketings	Govt. payments	Non-money income	Other farm income	Total			Gross	Net
	Million dollars							Dollars	
NEBRASKA									
1971	2,180.5	171.0	73.4	21.6	2,446.5	2,039.0	407.4	33,979	5,670
1972	2,821.4	233.3	81.1	22.2	3,158.0	2,520.6	637.4	44,479	8,912
1973	3,958.3	151.8	96.8	27.4	4,234.0	3,301.0	933.0	60,486	13,579
1974	4,070.0	21.0	117.5	33.4	4,242.0	3,109.1	1,132.9	60,600	16,185
1975	3,859.0	71.7	127.9	41.9	4,100.5	3,226.9	873.7	59,428	12,662
1976	3,827.9	36.6	155.0	46.1	4,065.6	3,670.9	394.7	58,922	5,720
1977	3,975.0	92.9	173.0	56.4	4,297.3	3,994.4	302.9	65,112	4,590
1978	4,683.4	268.6	185.5	61.7	5,199.3	4,726.3	473.0	78,777	7,167
1979	5,918.5	132.7	238.3	77.2	6,366.7	5,749.6	617.1	97,949	9,494
1980	6,074.7	82.9	267.8	80.3	6,505.7	6,281.0	224.7	100,088	3,598
UNITED STATES									
1971	52,859	3,143	3,958	641	60,603	47,367	13,236	20,883	4,564
1972	61,190	3,961	4,305	663	70,119	52,315	17,804	24,517	6,226
1973	87,068	2,607	5,017	813	95,505	65,562	29,943	33,831	10,607
1974	92,449	531	5,982	989	99,951	72,210	27,741	35,761	9,925
1975	88,209	807	6,689	1,233	96,938	75,863	21,075	35,034	7,611
1976	94,780	734	7,307	1,357	104,177	83,131	21,046	38,051	7,687
1977	95,289	1,819	8,044	1,561	106,713	90,293	16,420	43,860	7,093
1978	112,924	3,030	9,309	1,710	126,973	101,087	25,886	52,118	10,625
1979	131,916	1,375	11,150	2,129	146,570	119,217	27,353	60,318	11,530
1980	136,431	1,286	12,578	2,217	152,512	130,656	21,856	62,818	9,002

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Mr. DAUB. Are these all farms from your institution or this——

Mr. WARDELL. This is from eastern Nebraska.

Mr. DAUB. Eastern Nebraska.

Mr. WARDELL. Yes.

Mr. DAUB. One of the things I felt that my counsel from the city, Detroit, would have said, when you are talking about nonmoney income, is: How many of your borrowers right now make more money from outside income instead, working down on a job in Omaha, than they do making at the farm to pay your bank note or your interest?

Mr. WARDELL. It is true that that happens, although the clientele that I have specifically mentioned are full-time farmers basically.

Mr. DAUB. I wonder, if you will have ever a chance to look at figures and find out how much of that $15,606 might come from——

Mr. WARDELL. It comes from in a lot of cases, particularly young farmers——

Mr. DAUB. Is the wife working?

Mr. WARDELL. Yes.

Mr. DAUB. All right.

Mr. WARDELL. I would like to point out that I think you have posed a real question as to what kind of income——

Mr. DAUB. Nonmoney income is out there, more workers, more hands on work here to plow those fields so he should be careful. [Laughter.]

Mr. WARDELL. They say that there has to be an adjustment. Obviously, it can't continue at a loss. You can't continue this trend, looking on that back page; net farm income expressed as a percentage of the gross had or has declined from a high in 1974 of 26 to 27 percent, down to less than 4 percent.

Mr. DAUB. So what is the answer?

Mr. WARDELL. I think that eventually the consumers are going to have to pay more for their food and in terms of a percentage of their takehome pay than they are now.

The figure that I hear, I don't know if it is accurate or not, in the United States, consumers use 17 percent of their income for food which is the lowest in the world.

We have to conclude that expenses are going to come down or income is going to come up. So you start applying a little logic to that. What expenses can come down?

A lot of the popular talk in the country these days is that land prices have to come down.

That is probably true; maybe they will; maybe they won't. I am not going to speculate on that, but I would like you to turn back to that middle page, and look for a moment at some data in Nebraska.

Two particular expense items are taxes on property and interest on property.

Now I also am president of the school board and I will tell you that property taxes are not going to decrease.

I will also tell you that since 1974, there has been a tremendous amount of refinancing, short-term debt to long term.

Those loans are placed on to real estate by the Federal land banks from Farmers Home Administration, insurance agencies and so forth.

They are long-term debts from 30 to 35 years maturity.

This figure here, as you see, interest on real estate has gone up in total dollars, so has the tax.

It is not going to go down no matter what the value of that real estate is. Those loans and the public debt, that is, the taxes on that, are in place and they are not coming down.

It is interesting to know and I did not know this, and it shocked me to see that the obligations per year, what you could call "cash rent" against the land in Nebraska, every acre, is $91.74.

I just can't believe that a guy out on or in the Sandhill for example can pay that on some of that land that it takes 10 acres to run one cow on.

Mr. DAUB. Are those farms?

Mr. WARDELL. No, ranches.

Mr. DAUB. Are we going to lose farms overall here? Is this what you are saying, that part of it is higher prices to the consumer and you are going to lose farms too, there will be bigger ones and consolidations?

Mr. WARDELL. Yes, that is what happens or has to happen because going back to the farmer's living needs, he requires 15,000 or 16,000 to live on and the declining net, percentage of gross, means that he has to gross more every year just to be able to live.

Mr. DAUB. Can he——

Mr. WARDELL. So he has to get bigger just to live.

Mr. DAUB. What about the farm bill subsidies, target price loans?

Mr. WARDELL. I guess that I am not too much concerned about that.

You know, I am glad to see that we have got a reserve program and apparently I heard this morning that you can put corn in reserve and you get paid storage on it.

Mr. DAUB. That was the day before yesterday that that was opened, right?

Mr. WARDELL. The interest rate is 14½ percent as I understand, which is high.

Mr. DAUB. And the potential labor for the last 2 years of a 3-year loan, right?

Mr. WARDELL. Right.

What does that do for the guy that needs the money today?

He is going to pay 14 percent on that, on that anyway. He is forced to, less than he was the day before yesterday, cash in a crop at a loss.

Here again, that compounds the interest.

Mr. DAUB. As you said, when you first started off, the problem was the carried-forward debt on the previous losses?

Mr. WARDELL. Right.

We can show you that when you have 2 years of losses in farm business and in the cattle feeding business, there has been virtually no profit for 5 years and in 1980, with a loss of $10 per hundred, per hundredweight. That is $100 per head average.

Mr. DAUB. Embargoes versus increased export sales, how does that affect Nebraska?

Mr. WARDELL. That is what I wanted to say. These target prices are fine, but I think that we are more concerned about the lid that is not expressed in public policy that any time we get commodities up to where there is a break even, then we are stuck with an embargo; both Republican and Democrat administrations have done that.

Mr. DAUB. Does the farm bill have that trigger mechanism on that? Maybe it is in there. There is a device placed on the new farm bill awaiting final debate in the House that my colleague is most involved in and most responsible, as a matter of fact, for what I consider to probably be the most major provision that comes out of this debate which was passed yesterday on is an amendment on area price supports on sugar.

It places a great deal of discretion on the Secretary for the next 4 years and he has my appreciation for that, for the State of Nebraska.

I think that what will help maybe is that there is an assurance that if there is an embargo commodity that there is some kind of triggering mechanism that will pay or subsidize the loss.

Mr. BEDELL. There are different provisions in the Senate bill and there are also provisions in the House.

Mr. DAUB. My concern is that if there is an insurance program for embargo, then it may make it easier for the Executive to embargo.

So I hope——

Mr. BEDELL. No, that is to the contrary.

Mr. DAUB. I just hope that is not the case anyway.

Mr. BEDELL. No.

Mr. DAUB. I think it would be very expensive and so on.

Mr. WARDELL. Just one more comment.

Mr. Dickinson commented about restrictive credit and that was a very good comment.

It has been too free, I think, because it has been on an up and many lenders have been guilty of relying on collateral and not on cash flow.

I think that still goes on, but in the past, the concern has been to supply money to agriculture. I do not think that that is a concern. I think it is pretty obvious as I have shown you here that the concern now is reparability and the question right now, the cash flow of farmers right now, and it is going to be tough to show over a period, so it, the credit is going to be limited now.

Mr. DAUB. Is that what you think you are going to be doing, you are going to be tightening down loaning then——

Mr. WARDELL. The farmers are already doing that, themselves, as demonstrated by the fact that the Massey Ferguson & International are in such trouble, because they are not buying anything.

Mr. DAUB. Thank you.

Mr. BEDELL. The interest on real estate, is that what the computed interest would be on that real estate if it were current interest rates, the column right here that says interest on real estate?

Mr. WARDELL. That is actual dollars, the interest rate paid.

Mr. BEDELL. So it would be significantly higher than that if——

Mr. WARDELL. Yes; 1981 would be higher.

Mr. DAUB. Right.

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Mr. BEDELL. If you owned a farm and had the farm paid for, then it would be zero in this; is that right?

Mr. WARDELL. Right; except the taxes.

This is an average loan, so you can see what Mr. Dickinson is talking about, a 12-percent loan on $1,800.

Mr. BEDELL. If farmland values were to drop by 20 percent, that would significantly alter the securities due them on your loan.

Mr. WARDELL. Yes.

Mr. BEDELL. Would that cause serious problems as far as farmers, where their land is concerned, or would it, would you pay the 20-percent drop or——

Mr. WARDELL. Of course, on a short-term loan, we loan on production, so the value of land is not that important, it is your net worth statement, but the most important thing to us, of course, is the cash flow and——

Mr. BEDELL. But would that particularly adversely affect your operating levels or anything?

Mr. WARDELL. Indirectly it would.

Mr. BEDELL. It would?

Mr. WARDELL. Because the value of land ultimately, it wouldn't pay you back then.

Mr. BEDELL. If you had somebody with a negative net worth, if you thought they might make money next year you would still loan it to them?

Mr. WARDELL. That would be a problem. [Laughter.]

Mr. BEDELL. That is not an impossibility; is it?

Mr. WARDELL. Well——

Mr. BEDELL. For farmers; or is it?

Mr. WARDELL. That would be an individual decision that would have to be made.

Mr. BEDELL. No, no. A 20-percent drop in today, in land values from today's value could cause some farmers to have negative net worth; could it not?

Mr. WARDELL. Oh, yes.

Mr. DAUB. Well, if you pull the valuable land out of most net worth statements I have seen of farmers under age 40, they have got a negative net worth to begin with then.

Mr. WARDELL. A lot of them over that, or older than that.

Mr. DAUB. I suppose.

Mr. WARDELL. Yes.

Mr. DAUB. I wanted to be kind. [Laughter.]

But then when you add what you say, and I think a very realistic potential scenario, yes, you have really had and added an awful lot to this hearing.

Your preparation is appreciated.

Thank you very much for coming.

Mr. WARDELL. Thank you.

Mr. DAUB. You are entirely welcome.

Bob Pettegrew is here, with the Nebraska Home Builders.

Please come forward and take a seat.

I appreciate you being here and I guess and I hope it is an opportunity then for you to express your feelings and the concerns of the Nebraska Home Builders.

As its president, we welcome you and look forward to what you have to say.

Proceed.

Mr. PETTEGREW. Thank you.

TESTIMONY OF ROBERT PETTEGREW, PRESIDENT, NEBRASKA HOME BUILDERS ASSOCIATION

Mr. PETTEGREW. Congressmen, I apologize for being late.

Today I represent the home building industry and myself as a small builder in the community of Omaha. I have been a builder in the community for about 18 years and represent not only myself but also the 1,300 members of the Nebraska State Home Builders Association which includes 6,000 builders at the present time and going down steadily. As you have read, some of our public relations that we are putting out on a national scale and will be putting out on a local scale as far as what we can do as an industry, and some of the things that need to be done with our key campaign are really designed to get the attention of everybody.

As an industry, locally we are very happy with your effort on the Hill to the present time.

When we start getting our keys in the mail, we are not really coming at you with something that is negative.

Mr. DAUB. Do you know or notice how cautious he is when he says, to this time and admonishes us both, to this time? [Laughter.]

He is very careful. We notice your watchfulness. [Laughter.]

Is this a new campaign? We have not received any keys yet. What is this thing about?

Mr. PETTEGREW. You will be receiving many. They are in the mail.

Mr. DAUB. They are in the mail?

Mr. PETTEGREW. It seems that Congress, once they get in session, and have the first 120 to a 150 days under their belt that all of a sudden they sometimes tend to forget why they are there.

Our economy, as it exists today, and our industry, in particular, among others, that are hurt by this credit crunch with the high interest rate situation. We cannot survive "politicking" by Congress at this particular point in time.

It would appear that the Federal Reserve has decided to stay with their policy even though Mr. Volcker has said, that once inflation got to a reasonable level that would be the time when the Fed would begin easing off on their part and get the economy rolling again.

That has not happened to date; so far it is just talk. The prime rate has come down some, which, if it is a direction and an indication of where we are going, that is great, and we certainly hope that is what it is, but I am afraid that we are going to cure the disease and also kill the patient.

If they hold on to this interest thing too long, our industry will collapse. Businesses are falling off of the rolls of paying any more taxes to the U.S. Government that is going to help them pay for their already too many employees.

Every day goes by. Another business goes down the tube and so it is not, it is all over the country, and it is not just here in Omaha.

I was reading an article in the Wall Street Journal this morning about Idaho, and the problems we are having up there in the Silver Valley.

Mr. DAUB. Right. I saw that.

Mr. PETTEGREW. Just going to close up there primarily, a 100-year-old situation up there, primarly due to the economy, as a whole, not anything to do with their particular little end of the world, but what goes on in Detroit and all over the country.

We have got to get people back to work. We have got to get production started and we cannot do it with the interest rates that are on the books today.

I realize that the Federal Reserve is supposed to be a separate entity but somebody has got to get the people pulling the purse strings and get them out here to Omaha, Nebr., and Kansas City, and Denver, and take a look around at what is going on out there and what they are doing.

Now, inflation is another problem we have got, and we certainly do not want rampant inflation to get started again. But whatever it takes to get the economy rolling again, we had better get it rolling soon or it is all going to go down the tubes.

The homebuilding industry, is doing what it can to survive but with the mortgage rates what they are it is not easy. The savings and loans do not have much money and what money they have, they are charging an arm and a leg for, only because they have to pay an arm and a leg for it.

So it is a vicious circle. It is a cat chasing its tail.

But we had better get the Government program and the Federal Reserve program on track. If they stop looking at 3-month-old and 2-month-old figures, and that is the way they make their decisions, they get all of these barometers that are really probably only 60- to 70-percent accurate anyway, and then they are 2 and 3 months old and then they make a decision today on those barometers.

There is so much going on between now and the time those figures were compiled that it is not even funny.

So things happen too quickly; faster than they realize, in fact.

By the time the information gets to Washington, like I say, they will cure the disease, but the patient will have died and it will not make any difference.

We appreciate your effort. I appreciate your time and if you have any questions——

Mr. DAUB. On the contrary, we are trying to do our job and we appreciate yours.

The question of inflation first, we are at a level of approximately 9 percent now and Volcker has indicated he wants that level to be 7 percent.

I have some disagreement but I would say candidly I do not think that we can sustain ourselves at 7 percent. I do not think that we can reach it or sustain ourselves at it.

But we may be able to sustain ourselves between 8, 9, or maybe 10 percent, by the end of the year. We will wait, have to wait and see a little bit.

What do you think the interest rate has to be? If he sees the stability, maybe, he may be inclined to sort of start looking at the devices they have?

They have three devices. They have the discount rate; they have the margin requirement; they have their open market policies; they buy and sell in the open market through that function.

What does the interest rate have to be to put your industry back on a healthy trend, 18 percent, 14, 16?

Mr. PETTEGREW. What interest rate, are you talking about?

Mr. DAUB. I am talking about what you want to pay.

Mr. PETTEGREW. Home mortgages?

Mr. DAUB. No; what the builder is going to have to pay to borrow to build homes.

Mr. PETTEGREW. No; that is basically the mortgage rate.

Some builders borrow on a prime rate basis, but if you are talking about prime rate, prime rate situations——

Mr. DAUB. I am talking about say Barry Larson, who testified earlier, or you, in your own business; what does your cost of money have to be to encourage you to start building again?

Mr. PETTEGREW. My cost of money really has no bearing on it. What has a bearing on it is the consumer's cost of money.

Mr. DAUB. OK.

Mr. PETTEGREW. The consumer is the man that goes down to the savings and loan and says, I want to build an $80,000 house and I want to borrow $60,000, and I will buy it, I will build it today, if I can do it for 12 percent, maybe 13-percent range.

When interest rates got to 14 percent, the market stopped. There were some buyers in the 13- to 14-percent range, but basically few.

The majority of them were down below the 13 percent.

Mr. DAUB. Did the Nebraska mortgage fund help you at all?

Mr. PETTEGREW. The Nebraska mortgage finance fund did help in 1980 to, in the market as a whole. It produced some new product and it also produced a goodly share of what was sold in the used market.

It helped, even, rather, very definitely, the first time buyer kind of get off the boards.

Right now, as you are well aware, we have got the problem with the arbitrage rate and until they get that straightened around, that is not going to go anywhere.

But with interest rates the way they are today, I am not sure it would make any difference, because they just can't get that interest up high enough that would do any good in the real estate market.

The next time there is a vacancy, on the Federal Reserve Board, we need to get a representative of small business in there, who understands how to make a living and how to make a business go.

The Government does not understand how to run a business very obviously.

You know, if they did, we would not be in this mess.

Mr. DAUB. You are looking at two small business persons right up here. We hear you loud and clear.

Mr. PETTEGREW. So that is one of our angles.

The other thing is that we would like to have Mr. Volcker work at the high end of his target, instead of the low end of his target and probably would accomplish the same thing, but if he doesn't do something soon, nobody is going to accomplish anything.

Mr. DAUB. If you look at the 6½ percent, expansion money instead of the 4½ percent.

Mr. PETTEGREW. Instead of 3.

Mr. DAUB. Yes.

Mr. PETTEGREW. Well, 6 and 3 or 4½ and 3, whatever it, his range, is.

But he appears to be always looking at the low side and now he is talking about 7 percent and he was talking about 9 percent.

He keeps lowering everything as time goes on and that is commendable, because he to this time probably is the only one that has been fighting inflation problems. The Federal Government certainly has not.

Since October 1, 1979, when new Federal policies went into effect, the inflation rate has moderated. If opening the monetary spigot a little bit will get some production going again, so we can start paying some taxes, this will help. The clincher, is that if the Government has to continue to pay the rates that are on the books today, they are going to have to just start cutting off office building after office building and workers and everything else to meet the budget.

That is the compound problem.

Mr. DAUB. I am very aware of that. I am glad you mentioned that.

We appreciate it and particularly your membership. As much as we are looking forward to receiving the keys across this country from homebuilders, may I say to you that some of us are going to try to be ahead of that kind of a grassroots movement.

We know 6 months from now that we are looking at a tough situation for all of your membership and we are going to see what we can do.

The All-Savers Certificates program, how does it affect you in your relationship with the savings and loans?

Mr. PETTEGREW. That is a good question, Congressman.

To date, the all-savers program brought in about $15 billion. They repute that.

The problem with it at the present time is just that a lot of it is just turnover money. It is——

Mr. DAUB. Is this in mediation——

Mr. PETTEGREW. A lot, a guy has got a 6-month certificate and now he just flops it over into an interest free area, or a tax free situation.

I don't think there are any figures on that yet, as to how much of that has happened.

I think over a period of time, when other types of securities that people have mature, you know, say over the next 3 months, that, for 4 months, that some of that money may go and when that trend starts to hit people in the face, they are going to start pulling their money out and hopefully go into something like that.

It is a shortcut. It is a short-term solution unless they extend it in 1984 or whenever. We would hope that it would start a direction of the money back to the S. & L.'s, because those are the nuts and bolts of the housing industry. There is no question about it.

They are trying to, the banking industry is trying to push the savings and loans into becoming more like a bank and less like

what they are supposed to be and I think that most of them would like to just stay where they are and do home loans.

They don't want to be consumer loans and people and all that, but a lot of them are being forced into it for competitive reasons to try and compete with the banks who never made a house loan in one, you know——

Mr. DAUB. Do the thrift institutions that you talk to in your formal capacity on behalf of your industry indicate what they or that they think the all savers will channel money into new home construction this year or next year?

Mr. PETTEGREW. I think they are a little guarded in their comments along that line.

They certainly hope that the influx of money is there, but I don't think it is going to, I don't really personally think it is going to be the answer to our problem.

It is going to be one of many items that are or will help, you know.

Mr. DAUB. I would offer an observation, that jawboning is effective sometimes, so maybe if the president of the Home Builders would jawbone the savings and loans about some of that new money they get, that might be as helpful as the President jawboning Congress or Congress jawboning the President.

Mr. PETTEGREW. If we had a longer term on it, 15 months and then if you renewed it on the 15th month, I guess it could conceivably extend out 27 months as far as the money paid.

Mr. DAUB. What about December 31?

Mr. PETTEGREW. You see that is borrowing short and loaning long term to them.

So that I see as a problem, if they would put some potential for expending that, or extending that out further, or making that a little longer terms than 3 years or possibly 27 months, even 3 years would have been better, because a lot of them are on a 3-year rollover program with their mortgages.

But with no particular guarantee that the all-savers is going to be extended, that presents some potential, not wanting to loan long and going down and buy a Ginnie Mae certificate instead.

Whoever got that one through, really hammered it in pretty good and that is going to be where a lot of the money goes.

Mr. DAUB. I really appreciate your taking time to be with us and for your information. It is valuable.

Mr. PETTEGREW. Thank you.

Mr. DAUB. Thank you very much.

Bob Bernier, from the Nebraska Business Development Center, we are proud of your work and glad that we have one in Nebraska at the University of Nebraska, in Omaha.

It is good to see you again.

Congressman Bedell and I are interested in your comments.

Please proceed.

Mr. BERNIER. Thank you.

I have a copy of my testimony and I will just briefly go through parts of it and let you have the rest of it for the record.

[Mr. Bernier's prepared statement follows:]

PREPARED STATEMENT OF ROBERT E. BERNIER, DIRECTOR, NEBRASKA BUSINESS DEVELOPMENT CENTER

Thank you for this opportunity to testify on the impact of high interest rates on the business community in Nebraska. It is a problem that concerns us very much in our efforts to assist small businesses in Nebraska.

The Nebraska Business Development Center provides management and technical assistance to small businesses in Nebraska through direct counseling and management training programs. It is partially funded by the U.S. Small Busniness Administration through the Small Business Development Center program.

In the past year, the Nebraska Business Development Center has provided direct counseling assistance to more than 500 small businesses in Nebraska and has served hundreds more through its training programs. The impact of high interest rates on small business has been reflected in the demand for the NBDC programs in financial planning and cash flow analysis. The Nebraska Business Development Center has also encountered a number of small businesses looking for sources of lower interest loans. These are almost impossible to obtain.

The Nebraska Business Development Center serves small businesses throughout Nebraska. A unit of the College of Business Administration, the University of Nebraska at Omaha, the Nebraska Business Development Center serves other geographical areas of Nebraska through subcontracts with the colleges and schools of business at the University of Nebraska-Lincoln, Kearney State College, Wayne State College and Chardon State College.

COMPOUNDING EFFECTS OF REDUCED CONSUMER SPENDING

While the Nebraska Business Development Center has encountered concern among its clients over high interest rates for at least the past two years, this concern has been compounded in the last year by increasing concern about volume of sales. This concern occurred initially among businesses surving rural areas where a depressed farm income has hurt retail consumer sales. This concern is more recently becoming apparent in urban areas as well.

To demonstrate the combined affect of high interest rates and lower volume as a result of reduced consumer spending, the Nebraska Business Development Center has developed a profile of a typical retail firm in Nebraska (Exhibit A). This profile demonstrates that high interest rates have depressed earnings in retail firms and that the combined affects of reduced sales results in negative income for many of these firms.

The example shows a firm with $250,000 of gross sales. It presumes an inventory turnover ratio of 4 times. While this has been considered typical for small firms in Nebraska, it is important to note that many small firms have gross sales considerably below the $250,000 level and are thus less able to absorb high interest rates. In addition, the Nebraska Business Development Center has found that many of its clients are experiencing turnover ratios significantly below 4 times. Some, even less than two times per year. The combined affects of low turnover and high interest rates have caused several bankruptcies and can be expected to cause many more in the coming year.

STATEMENTS OF NBDC CLIENTS

The analysis performed for NBDC clients is confidential. However, some of our clients have given us permission to tell their story as part of this testimoy.

James Buss owns Jim's Jack and Jill food store in Minden, Nebraska. Mr. Buss says that he cannot increase volume enough to compensate for the increased interest rates. "There are ony 2,700 people in Minden," he says, "and I can't squeeze any more out of them. I can't hold on much loger. Without an increase in volume or a drop in interest rates, I will be out of business." Mr. Buss notes that his banker has been working with him and that without his cooperation he would be in worse trouble.

Jack Rasmussen is the owner of Jack's Tire Service in Grand Island. Like many other businesses, he is faced with an increase in the cost of inventory and an increase in the interest he must pay on money borrowed to carry inventory. "Inventory cost has increased dramatically," he says, "but we cannot afford to carry the inventory because the interest rates are too high."

Mr. Rasmussen notes that his ability to carry inventory hurts his customers as well as his business. For example, if a farmer blows a tire on his tractor and Mr. Rasmussen doesn't have a replacement tire in stock, the farmer must wait two weeks for delivery. In the meantime, he has missed his opportune time for getting in his crops.

Mr. Rasmussen also notes that bankruptcies of other companies in Grand Island have hurt his sales and have resulted in the loss of money owed to him from previous sales to the bankrupt firms. He and other business owners in Grand Island are quite concerned about the inability of their firms to receive some payments on accounts receivable owned by bankrupt and liquidated firms. These debts are unsecured, therefore the secured debts to banks and other lenders are paid off first. Mr. Rasmussen expects another wave of bankruptcies in Grand Island this year.

Those firms which are remaining profitable are often working on funds secured from older loans at lower interest rates. The Hamilton Motor Inn in Aurora, Nebraska, for example, has refrained from borrowing new money and is still able to work off of older loans with rates of 8½ to 10 percent.

It is more difficult to lock in rates in today's market. Sargent Variety and TV in Sargent, Nebraska, for example, has a note with a 17½ percent rate that is subject to change every six months. The owner notes that he has hoped to borrow at 12 percent and was unable to borrow in his town. He went to Taylor, Nebraska for financing.

The availability of funds at higher rates is not certain. Some firms have reported no problems with availability if they are willing to pay the higher rates. However, others report that even at 19 to 20 percent they are finding problems with availability.

EFFECTS ON NEW BUSINESS

Early this year, the Nebraska Business Development Center noted a rise in the number of individuals seeking to enter a business. This is a common situation when unemployment or underemployment rises. The avenue of self-employment is difficult, however, because of the cost of financing start-up businesses.

Many of these individuals have looking for Small Business Administration loans at lower rates. The SBA guaranteed loan program, however, allows interest rates at 2¾ percent above the prime. In today's market that is a loan rate of 22 to 23 percent. SBA direct loans have been lower than this level, but, the amount of funds is limited and firms must demonstrate that they are unable to obtain guaranteed loans to qualify.

Many of those individuals who have succeeded in establishing a business in recent years have done so by going into a business that requires little capital. Patricia Leslie of Leslie Public Relations in Omaha, for example, reports that she is not borrowing any funds for her business. She still feels high interest rates affect her, however, because firms are reducing expenses to avoid financing needs. Phyllis Harper has also been able to establish a one women cleaning service because she hasn't had to borrow any money to go into the business.

OPPORTUNITY FOR THE DISHONEST

Today's high interest rates have also created a market situation that permits dishonest speculators to profit from the search by entreprenurs for low-cost money.

Just yesterday, we counseled a client who was seeking a $1 million loan for plant expansion. He had been attracted to a so-called finance company that promised to arrange lending of the full amount at nine percent interest. However, they required that the company first pay a three percent or $30,000 upfront finders fee for the financing.

We advise the client that this was not an accepted practice and illegal in Nebraska. We also investigated the financing company he had corresponded with and found it was an individual working out of his home who did not have a license to practice in Nebraska. While we cannot be certain that this person was attempting to be deceptive, the case does indicate the caution with which businesses must pursue financing.

DEREGULATION OF FINANCING COMPANIES

There is, finally, a growing concern among small businesses that the deregulation of financing companies will result in large corporations that are less concerned about the survival of busineses in their communities.

While no one can be certain about the affects of such proposed liberalization of financing laws as interstate banking, it is a concern which should be addressed when considering these changes. Will a corporation with headquarters in Minneapolis or Chicago or New York be concerned about the survival of a small firm in Sargent or Aurora or even Omaha?

WHAT BUSINESSES ARE DOING

As the interest rates on debt have climbed, as the cost of inventory l risen, as the demand by consumers has fallen, businesses have been very concerned about their cash flow positions. During the past two years, the Nebraska Business Development Center has conducted in-depth financial planning analysis for hundreds of these firms. Many more have sought guidance from their accountants and other business advisors.

These firms have become increasingly concerned with the cash flow in their businesses. They are planning better. They are holding down expenses. Many are surviving.

This emphasis on financial management is producing better managed firms with a base for improved performance when interest rates come down and/or consumer spending increases. The recent economic recovery act, with its reduction in tax rates, may help consumer spending. But, while these are important and productive measures that businesses are taking, many can not afford to wait much longer for an economic upturn.

EXHIBIT A

	10 percent	22.75 percent
Profile of typical retail firm at 10- and 22.75-percent financing of receivables and inventory:		
Sales	$250,000	$250,000
Cost of goods sold	150,000	150,000
Gross profit	100,000	100,000
Expenses less interest	75,000	75,000
Net profit before interest and taxes	25,000	25,000
Interest	6,750	15,356
Profit before tax	18,250	9,644
Result when turnover drops to 3 times per year:		
Sales	187,500	187,500
Cost of goods sold	112,500	112,500
Gross profit	75,000	75,000
Expenses less interest	75,000	75,000
Net profit before interest and taxes	0	0
Interest	6,750	15,356
Net loss	(6,750)	(15,356)

Note.—Based on 4 turnovers a year for an inventory average of $37,500 and accounts receivable at 12 percent of sales or $30,000.

TESTIMONY OF ROBERT E. BERNIER, DIRECTOR, NEBRASKA BUSINESS DEVELOPMENT CENTER

Mr. BERNIER. One of the things that I did in my statement, I focused here on the retail and service small business industry rather than on construction, and farming, which you have already heard from today, is to talk about how the high interest rates are affecting them and basically what I wanted to show were examples of what we consider a typical retail firm in Nebraska that has a good market, that does about a quarter of a million dollars' gross sales a year, what kind of profits that firm generally is able to expect, and what happens to profits when interest rates increase.

In the example that I have, a firm like that can expect to have a profit before tax of a little over $18,000, on a 10-percent interest rate.

When the interest gets up to the range where some of the small businesses had or have had to borrow recently in the 20- to 22-percent range, or even higher, as you know, an SBA-guaranteed loan can go 2¾ above the prime, then if the prime is at 20 percent, that is 22¾ percent interest on a loan.

The next profit is that before tax and drops to less than $10,000. What has been happening is that retail firms have been able to sustain themselves at that kind of an interest rate as long as their turnover remained high, as long as they were able to sell enough goods.

Their margin has been reduced; their profit has been reduced, but now the turnover is being reduced too.

We used to expect that a good retail firm, that we had as a client, should have a turnover of four times a year, from the average kind of business.

Now, we see turnovers of three, sometimes less, sometimes two times a year. At first, this occurred in the rural areas, where farming income had resulted in lower turnover.

Now, we are beginning to see the effects in the urban areas as well. When turnover and margin are both reduced, we do come into an unprofitable situation for the firms.

The analysis that we perform for our clients is confidential but we have talked to some of our clients and gotten permission to include some of their stories in our testimony today.

So I would like to share a couple of them with you.

James Buss, who owns Jack & Jill Food Store in Minden, Nebr., says he cannot increase volume enough to compensate for the increased interest rates, and I am quoting him, "There are only 2,700 people in Minden and I can't squeeze any more out of them; I can't hold on much longer; without an increase in volume or a drop in interest rates, I will be out of business."

Mr. DAUB. Is he already borrowed up, I mean, based on his books? Is he already at a short- or long-term debt situation where that is as far as the banker is going to go with him?

Mr. BERNIER. Yes.

Mr. DAUB. SBA loan guarantee?

Mr. BERNIER. Yes. He has indicated that his banker has helped him out so far, he would be in worse trouble if his banker had not, but he is at the end of the ropes now.

That is a point that I was going to make later, but I will just go ahead and say it now, that the kinds of interim measures that these firms have taken have gotten a 2-year period of low turnover and high interest rates, but they cannot last much longer.

They are dealing with the end of the road.

Jack Rasmussen is owner of Jack's Tire Service in Grand Island. Like many other businesses, he is faced with the increase in the cost of inventory and the increase in the interest in his payment on money to carry inventory.

Inventory costs have increased dramatically, he says, "We cannot afford to carry the inventory, because the interest rates are too high."

He notes that this inability hurts his customers as well.

If a farmer blows a tire on his tractor, then that farmer must wait 2 weeks for that tire to come in, because he cannot afford to carry it in stock.

He has also been hurt by bankruptcies in the Grand Island area and the inability to collect accounts receivable from those individuals or those small businesses that are going bankrupt and he expects another wave of bankruptcies in Grand Island this year.

Mr. DAUB. Because of your following at the business center here on that point, ancillary to this situation in Grand Island, what are the levels of bankruptcies in Nebraska compared to a year ago? Do you happen to know that?

Mr. BERNIER. I do not know what those rates are. I will say that bankruptcies in Grand Island are higher than they are in some of the other communities, because of the tornado 2 years ago and some of those firms were not adequately financed to recover.

Mr. DAUB. So it is not necessarily in line with interest rates, as a percentage of increase and bankruptcy, but other factors also might enter into it?

Mr. BERNIER. Yes, in that particular instance.

In that particular instance, the firms had to borrow the money to rebuild and they were borrowing at the higher rate.

A lot of the retail firms have old loans. For example, we talked to the Hamilton Motor Inn in Aurora. There they are able to survive, because they still have two old loans at 8½ and 10 percent to work off of.

As long as they can do that, they will be OK, but the businesses that have had to refinance are running into problems.

Earlier this year, we had a rise in the number of individuals seeking to enter business. This is a common situation when unemployment or underemployment rises.

The avenue of self-employment is difficult because of the cost of financing and so what we have noted is that the only people who are entering, or not the only people, but a large number of people who are entering business right now are those that can do so without borrowing any funds and those are marginal business for the large part.

We note here a client who has entered a one-woman cleaning service business and another who is in the public relations business and they have not had to borrow any money to start.

Mr. DAUB. So the few new businesses are starting with the lack of credit availability.

Mr. BERNIER. Right.

Mr. DAUB. It keeps them from getting into business, because they can't get a loan?

Mr. BERNIER. And they are looking for low-interest loans, of course, and frantically in some instances.

Mr. DAUB. I want to ask you to explain at this point, just for the record quickly, so we will not or so we can watch our time, exactly where you work and what the center does to give some enlightenment to those here with respect to why you have this particular kind of information available.

Mr. BERNIER. I am director of the Nebraska Business Development Center and that is a small business development center under the SBA program.

We provide direct counseling assistance to small businesses at no fee to them and we also offer workshops and seminars throughout the State to help businesses——

Mr. DAUB. You are located where?

Mr. BERNIER. We are located in this building, the first floor, and also at offices at the UNO and at Kearney State, Chadron State, and Wayne State.

Mr. DAUB. And how many of these business developments are there in the country?

Mr. BERNIER. There are 18 now. We were one of the first.

Mr. DAUB. You were one of the first ones established. How many clients do you service in a year's time approximately?

Mr. BERNIER. Last year, we had 535 clients for indepth counseling that we serviced in Nebraska and we had many hundreds more that attended our seminars, but for indepth kinds of things like I am talking about here, we had 535 clients.

Mr. DAUB. And how is your funding level for this coming fiscal year, 1982?

Mr. BERNIER. I don't know the answer to that question.

Mr. DAUB. Did you finish out OK for 1981?

Mr. BERNIER. Yes; we did.

Mr. DAUB. Did you get the extra funds that we were talking about?

Mr. BERNIER. Right.

Mr. DAUB. OK.

Mr. BERNIER. Two days ago.

Mr. DAUB. You got it?

Mr. BERNIER. Yes.

Mr. DAUB. OK.

Mr. BERNIER. We will not be seeking an increase in Federal support for our program next year. We are seeking the same level as we had for the previous 2 years and——

Mr. DAUB. Those are matching funds?

Mr. BERNIER. We will be getting an increase in matching funds, both from State and private sources.

Mr. DAUB. Very good.

You may go ahead. I was thinking that after some of these examples that they did not fit with maybe some of the listeners.

Why did you know all of this? How did you come up with all of this information?

Mr. BERNIER. I also wanted to note, and this is ancillary, I guess, but the high interest rates have also opened up the opportunity then for what may be dishonest practices may be in the credit markets.

Just yesterday we had a client who was seeking a $1 million loan for plant expansion and was attracted to a so-called finance company who was promising to arrange financing of the full amount at 9-percent interest, but he was demanding a 3-percent up front figure of $30,000 to arrange the financing.

Mr. DAUB. A nonrefundable fee, I presume?

Mr. BERNIER. Right. We counseled this person that that was an illegal practice in Nebraska, and not an accepted practice in financing circles.

Then we investigated and found that this person operated out of his home, did not have a license to practice in Nebraska. So businesses must be very careful about who they believe, especially, when those kinds of situations arise.

Mr. DAUB. Have you brought that particular matter to the attention of the State attorney general?

Mr. BERNIER. No; I have not. We——

Mr. DAUB. I might urge you to do so that others who may not have been smart enough to come to you, to find out about that, then do not get taken advantage of by that or similar schemes by the same or other persons in the time to come.

Mr. BERNIER. We have reported to the Better Business Bureau on that and I will follow up on the Attorney General.

I want to mention what businesses are doing about the high interest rates and that is that we have had a large increase in number of businesses who are seeking financial planning analysis and cash flow analysis.

They are trying to reduce their expenses so that they do not have to borrow as much money to carry inventory. They are cutting back on their inventory; they are tightening up on the credit so they do not have to carry as much accounts receivable.

Many of these things will make these businesses better managed and stronger firms should there be a turnaround.

But if we continue to have the high interest rates and the reduction in turnover, there will not be much, there is not that much time left.

There has to be a turnaround very soon for them to benefit from that.

Mr. DALTON. What do those accounts receivables look like for those firms that you have been involved with? Are they counting what, 60- to 90-day averages or are they mostly down to 30's?

Mr. BERNIER. Typically what has happened is that the firms would carry a 90-day average accounts receivable and that if they do not control their accounts receivable well that the accounts receivable will get beyond that level because of the drop in turnover.

Also, what happens is that we have run into a number of firms who are in a problem because they had purchased inventory and in the expectation of certain sales volumes and as those sales volumes have dropped off, not only are they left with higher levels of inventory than they need, but with old inventory, particularly in such areas as say women's ready to wear, that kind of thing where an inventory becomes dated and less salable, the farther out that it has to be carried.

So they have to, of course, have sales and try to dispose of that and then come up with smaller levels of inventory later.

But in those kinds of situations, we have found some folks unable to unload even at distressed prices merchandise that has been or become old.

Mr. DAUB. We appreciate that and we would like to have that information for the record, if we might.

We hope that you will keep, not only this member, but this subcommittee informed as this next year unfolds, if the interest rate problem advises to maybe the same set of information on an updated basis. If you would do that, we would appreciate it, OK?

Mr. BERNIER. OK.

Mr. DAUB. Thank you very much.

Could we have Greg Williams come, who is the president and owner of Sentry Buick here in Omaha.

We welcome this opportunity to benefit from your input and thank you for coming today.

Mr. WILLIAMS. First, I want to thank you, gentlemen, for inviting me.

I do have copies of what I want to say also.

I will just pass that out now.

Mr. DAUB. Maybe you will just summarize that too and then we can get at the most valuable part, and that is to have a chance to question you about your feelings on what you are saying to us.

[Mr. Williams' prepared statement follows:]

PREPARED STATEMENT OF GREGORY M. WILLIAMS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, SENTRY BUICK, INC.

My name is Gregory M. Williams. I am President, Chief Executive Officer and Shareholder of Sentry Buick, Inc. a Buick dealership located in Omaha, Nebraska which sells new and used automobiles. I am happy to have the opportunity to testify before this Committee this afternoon on the effect of high interest rates on small business, particularly the automobile industry.

I have been the President and Chief Executive Officer of Sentry Buick since March 5, 1979 at which time, I was employed in a management capacity in the automobile business for six years in New Orleans. Currently, in addition to my duties at Sentry Buick, I am active in the Omaha New Car Dealers Association for which I am Secretary-Treasurer. Although I am not here as an official representative of that Association, my close working relationship with other automobile dealers through that Association has given me the opportunity to become aware of the concerns of other automobile dealers in the Omaha metropolitan area.

There are three basic ways in which high interest rates effect small businesses, in particular, automobile dealerships.

The first effect results from our need for inventory financing. Because very few dealers own their inventory, i.e. the cars which sit on their showroom floors and on their lots, provisions must be made to finance this inventory for the period of time it is held by the dealer. This is commonly called floor-planning. Floor-planning usually involves General Motors Acceptance Corporation or some other financial institution which will purchase the cars on behalf of the individual dealer. The dealer will in turn pay interest on each automobile from the date on which it is acquired by that dealership to the date it is sold to a consumer. Because the interest rate paid bears a direct relationship to the then-current interest rate, there is an immediate impact and a direct relationship between interest rates and operating costs for car dealers. For example, my inventory is financed at an interest rate of 1¾ percent over the prime rate of interest. Because of the volume of my inventory or that of any other car dealer, any small increases in interest translates to a much larger amount in operating costs for the car dealer.

A second way in which high interest rates impact upon the small business is in the form of the financing of capital improvement items. This is true for car dealerships as it is for any business. If we need to borrow money to finance any real estate improvements, equipment or other capital items, the price we pay for the financing is dictated by the current interest rates.

Finally, any increase in interest rates results in an increase in the cost of automobiles to our consumers, and ultimately results in a decrease in car sales. When car sales are down, most of our operating costs such as personnel, equipment, and other overhead costs remain fixed so that there is a decrease in net earnings. Moreover, in a time of high interest rates the cost of inventory financing sharply increases, as discussed above. Thus, the car dealer is faced with a situation where his revenues have decreased and his operating costs have increased. As I am sure you are well aware, these occurences are only the beginning steps in a chain of events which ultimately affect the entire economy as there will undoubtedly be personnel layoffs and other cost adjustments at the dealer level as well as at the automotive manufacturers level.

Sentry Buick and other local automobile dealers have responded to the latter impact, i.e. the affect on consumer spending, by entering into a one-time joint venture with local banks. In this one-week campaign, during the summer of 1981, local banks agreed to lend money to purchasers of automobiles at a 13 percent rate of interest—six points under the then-current prime rate. The campaign worked well in that it did boost car sales for that period of time. However, that was only a temporary solution. In addition, it cost dealers and the banks money to undertake such a project. Nonetheless, we felt that it was worthwhile since it cost us more not to undertake such a project than it would to do so.

Our dealership has managed to do relatively well under the circumstances. However, unless there is some relief from the high interest rates, our future is uncertain. There are many dealerships that are struggling even now to survive. Unless that relief is forthcoming, I fear that we will see an increased number of bankruptcies and fraud in the automobile industry and the business community at large. We have already begun to see some of that right here in the Omaha area.

I urge you as Committee members to very carefully analyze this problem in a sincere attempt to find some of the best solutions. Again, I thank you for this opportunity to speak to you, and I welcome any questions you might have at this time.

TESTIMONY OF GREGORY M. WILLIAMS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, SENTRY BUICK, INC.

Mr. WILLIAMS. I will start by saying that I have been here in Omaha, Nebr., since March 5, 1979, when I purchased Sentry Buick which used to be Shelley Buick.

I am president and chief operator, the works, chief cook and bottle washer.

Mr. DAUB. And shut the door and even known if you have to.

Mr. WILLIAMS. That is right.

Since I have been here, when I went into business in March of 1979, I think the prime rate was somewhere in the area of 13 percent. The prime now is somewhere in the area of 19 percent to 20 percent.

It is especially important to us as automobile dealers, because I have approximately $3 million worth of inventory on the lot. I do not have $3 million.

We have something that we call "floor planning" in the automotive industry whereby we find a lending institution that is willing to loan us the moneys to pay off our cars when they hit our dealership right off of the trucks.

In my situation, that is 1¾ percent over prime. I pay 1¾ over prime over every automobile in my lot.

It impacts me to the point where I pay somewhere—last month, for instance, I paid over $40,000 to keep my inventory, nothing to do with any of my bills or any overhead.

Interest rates impact us in probably three ways. The most important way is the floor planning, itself, because when I have to pay $40,000 in order to keep the inventory in order to stay in business, it means that I have got to increase profits, sell more cars in a time when cars are not selling as readily as they did years ago.

I am fortunate enough, that my business is increasing, but automotive sales here in Omaha are not. My business has increased in the 3 years that I have been here about 150 percent and at this point, with interest rates increasing where they are, I am just keeping my head above water.

I am at a point where I am not at a loss, but I can't expect my business to continue growing like it has, so, consequently, I am very concerned about the interest rates because it is just a matter of time where it will impact myself and other dealers.

I have 60 people working for me and I am probably, I probably have less than most automobile dealers in town.

I am on the Omaha New Car Dealers Association. I am secretary-treasurer.

We have approximately 30 automobile dealers in town with an average of about 70 people working for them.

It has an impact on every community when the automotive industry is not functioning properly. The dealers recently got together with the banks here in Omaha and at a cost to ourselves and to the banks were able to afford our customers 13-percent interest rates.

We did that for 1 week, after some arm twisting at the banks and what have you, but we all do a lot of business with those banks.

We got them to lower their rates and we paid part of it to put this together. It worked. It was an excellent program and for 1 week we had more business than we have had in probably years.

This is something that we could not continue, but it is a stark example of the effect that the interest rate is having on the automotive industry and as it relates to everything else, the rippling effect that it has.

When the dealers are not selling cars, they are not buying cars from the factory which means that the factory has to lay off thousands upon thousands of people and when our overhead is going up the way it is, we have got to lay off people and we are talking about a rippling effect that is going to go throughout this country and that is happening right now.

We have got automotive dealers across the country right now who are in dire need of help.

I feel fortunate that at present I am not in that bad of shape as most, but I would say I am maybe in the top 10 percent.

We have got some automotive dealers who are in trouble, in deep trouble, and I think that if we do not get something done about interest rates real soon, it is going to impact upon our whole economy.

I think that is where you gentlemen come in.

Mr. DAUB. What kind of a year do you think is ahead for not just perhaps your own better managed business under the circumstances, because you have had some growth over this last 2 years, especially, but for the new car dealers especially this next year?

Mr. WILLIAMS. Sales for the Omaha metro area, and that is the one that I am most familiar with, have been down.

In 1979, it was down; in 1980, it was down more than 1979; and so far this year, it is down past 1981.

We have had several automobile dealers go out of business. Another one that is right next to me is an empty building on West Dodge.

I have been here 3 years and I have had two automobile dealers in that location who have gone out of business. We do not anticipate an awful lot, nor we do not anticipate many more sales, because of interest rates, but I guess I am fortunate and maybe a few other people are that as the pie is getting smaller, but I just happen to be getting a little bit larger piece of pie.

But what that does is move somebody else out and across the board and it is bad for the economy I cannot continue to expect my business to increase like that. I have got to realize that I am no superman and nor are my people and at some point, I have got to reach my potential, I have got to reach a level that my business will hit.

Mr. DAUB. Is 13 percent about where things break loose for you?

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Mr. WILLIAMS. Well——

Mr. DAUB. Or was it 10 or is it going to be 16? Have you made some assessment of what you might be able to do better at than the current rates?

Mr. WILLIAMS. We have discovered that at 13 right now we can do better, but that is only because rates have been so high.

Mr. DAUB. Psychologically——

Mr. WILLIAMS. When we got that down, when we got them to 13, people jumped on it.

Probably had rates been at 16, it may have taken 10 or it may have taken 9 to get people psychologically ready to spend the money.

I am not saying what interest rate it is going to have to be, because I am not foolish enough to think that we will ever get back to 8, 9, 5, or 7 percent.

I just think that we have to get it back somewhere reasonable, that this economy can function at and that this country can function at.

Mr. DAUB. Do you have any thoughts, just your own feelings, from your business acumen, what should be done vis-a-vis the Federal Reserve, the Government, the Congress, the executive branch, or the consumers' expectation of what credit could or should be available?

Mr. WILLIAMS. I end up with probably somewhere in the area of 12 percent. We will see people straight on the bottom yet.

Twelve to 13 percent is an area that is probably tolerated right now and I think that the Federal Reserve is doing probably a noble gesture right now and we are biting, all biting, the bullet, but there is only so far we can go.

I think that we have got an overdose of the medicine right now. That is causing an illness in itself.

Mr. DAUB. I see.

Mr. MARSH. I had one question. Is it more the psychological impact of high interest rates that keeps the consumer traffic out of the showroom or is it that the consumers actually cannot obtain the financing at the higher rates?

Mr. WILLIAMS. I think that it is probably the psychological impact. People can afford what it is that they want, I guess.

It has gotten to the point now where the general public has decided that they just will not, that they are not going to pay any more. They cannot afford to pay any more.

I happen to read something in the Wall Street Journal a couple of weeks ago and it is out of my field, but just to show you an example, the average home price now is somewhere in the area of $75 to $80 thousand and then I believe it is 20-percent down payment with the interest rates that they are and you are talking average payments now of $877 a month and not including insurance and taxes.

The question that was left there was where is the young guy coming out of college, the newlywed and what have you, going to get this type of money to spend. There are people out there who can afford that, but I doubt if there are people out there who want to spend that.

I think that it is a psychological thing. If we can get people spending money again and if we can get people purchasing automobiles and homes and what have you, automobiles are something I am familiar with, if we can get that back rolling again, we have got the economy rolling again, because we have got a General Motors and a Ford and an AMC that are generating again and hiring people back and putting these people back on rolls.

Consequently, those people are able to buy homes; those people are able to do the things that they need to do to live the way that they expect to live and we have got this rippling effect that is going to go throughout the economy.

I know that is what we need and we do not have.

Mr. DAUB. Could I ask you two specific questions?

Is that GMAC floor planning?

Mr. WILLIAMS. Yes.

Mr. DAUB. At 13.8?

Mr. WILLIAMS. No.

Mr. DAUB. Currently, what are you at?

Mr. WILLIAMS. Our floor plan is 21¾.

Mr. DAUB. Have they offered a 13.8 to you on a 1-year or 2-year deal?

Mr. WILLIAMS. No. There is 13.8 percent money to the retail consumer.

Mr. DAUB. I know.

Mr. WILLIAMS. And that is only a short period. Right now we have got 13.8 money on what we call the "X" cars, the Buick Skylark, the Chevy Citation, and what have you.

Mr. DAUB. Yes.

Mr. WILLIAMS. For 1 month only.

Mr. DAUB. For 1 month, but isn't there some or was there an offer of any kind of plan from your supplier of cars of some 1-year or 2-year program?

Mr. WILLIAMS. There is a 1-year program that General Motors had where they gave assistance to automobile dealers on the floor plan.

The only problem with that is that you had to sign for that period of time, that extended period of time, and whether interest rates went up or down——

Mr. DAUB. You were stuck with that.

Mr. WILLIAMS. Yes, you were stuck with it, and a lot of automobile dealers did not go with that in the hopes that interest rates would go down and they would be able to function better, because now you are talking an additional carrying cost to the cars when they come in, and we have already got increased prices of the automobiles.

We are paying for this through GM, but it is just that we are paying for it on the automobile, itself, when it comes in.

Mr. DAUB. You did not opt to get into that?

Mr. WILLIAMS. No, I did not. I am going to get into it now.

Mr. DAUB. You have got to get into it now?

Mr. WILLIAMS. Yes. [Laughter.]

Mr. DAUB. Listen. I hear you.

If you had to estimate, just speculate, from the memory of your books, a year ago, cost per car, in your floor plan, versus today's

cost per car, in terms of when it is in your lot and when you sell it, how much are you paying out in interest?

In other words, is it $1,200 a car, is it $900 a car, $2,000 a car, from last year to this year, the difference?

Mr. WILLIAMS. Let us take the average. If a car stayed in the inventory for an average of approximately 60 days, and that is a pretty quick turnover, we would be talking somewhere in the area of, at present, about 750 a day. Last year, it was about 350 a day.

Mr. DAUB. 350 a day.

Do you have more employees today in your business than you did a year ago?

Mr. WILLIAMS. I do, because my business is growing, but the bottomline is not growing. It is kind of like running on a treadmill.

If my business is growing and we had interest rates staying about the same, I would see a marked improvement in the bottomline, but with interest then, interest rates, growing the way they are, I am running on a treadmill and I am staying above water, but I have got to do or stay a hundred percent better than I did last year to do that.

Mr. DAUB. I understand.

Mr. WILLIAMS. And that is what I think the fair price system is all about.

Mr. DAUB. Thank you for coming and for the insight and your management skills. Hang in there and we will try to do our best.

Thank you very much. We appreciate the information.

Mr. WILLIAMS. Thank you.

Mr. DAUB. I would like to welcome Mr. Gordon McDonald, Nebraska State AFL-CIO president.

Will you come up and take a seat?

We are anxious to hear what you have to say.

Mr. McDonald.

TESTIMONY OF GORDON L. McDONALD, PRESIDENT, NEBRASKA STATE AFL-CIO

Mr. MCDONALD. Thank you.

For the record, my name is Gordon McDonald, president of the Nebraska State AFL-CIO.

We are an organization of approximately 50,000 members and 275 individual local unions within the State of Nebraska.

The makeup of the State AFL-CIO is comprised of men and women who are employed at construction jobs, in manufacturing and processing plants, on railroads, in wholesale and retail outlets, at city, county, State and Federal worksites and in schools, to name but a few, and in many other occupations.

Many of our members and their families have been hit hard by the high interest rates. In most industries, where our members are employed, at best, they are not hiring and worst, they have been and are currently laying off many good experienced employees.

I am told by our people that interest rates are one of the primary reasons.

If it is all right with you, I will skip some of these problems that high interest rates and tight money cause and get into maybe some of the suggestions for you.

We feel that it is imperative that we turn away from the disastrous reliance on tight money and high interest rates.

Specifically we urge the following immediate actions:

One, to channel credit to high priority areas;

Two, curtail the use of credit by speculators;

Three, limit the extension of credit for overseas ventures;

Four, make the Federal Reserve Board more representative of American society; and

Five, encourage use of pension funds for home mortgage loans.

I was not even going to make a presentation on that. I will get into that a little.

In our opinion, achieving these goals will require:

(*a*) Making the Credit Control Act of 1969 permanent in order to channel available credit to high priority areas and to discourage excessive speculation.

The act should be amended to prevent lender abuses in consumer credit and to require the Federal Reserve Board to promptly report to Congress on its credit control policies.

(*b*) Another part is giving the President authority to restrict U.S. capital investment abroad and curb the extension of credit to foreign ventures whenever it is deemed necessary to increase investment in domestic plant and equipment;

(*c*) Would be amending the Federal Reserve Act to enlarge the Board of Governors to 11 members and broaden its representation to include industry, labor, agriculture and consumers; and the last part,

(*d*) Would be encouraging the investment of pension funds in long-term, fixed payment mortgages, with appropriate insurance against loss, in order to help more families purchase housing.

Now, inflation, I know, is a complicated matter and I know you are doing what you can to try and bring it down, but all of our members think that high interest rates and tight money are probably the key cause of inflation and that we should reconsider some or all of those suggestions on that.

Mr. DAUB. I want to explore a little bit with you the five suggestions.

[Mr. McDonald's prepared statement follows:]

PREPARED STATEMENT OF GORDON L. MCDONALD, PRESIDENT, NEBRASKA STATE AFL-CIO

We are an organization of approximately 50,000 members and 275 individual local unions within the State of Nebraska. The makeup of the State AFL-CIO is comprised of men and women who are employed at construction jobs, in manufacturing and processing plants, on railroads, in wholesale and retail outlets, at city, county, state and federal worksites and in schools, to name but a few, and in many other occupations.

Many of our members and their families have been hit hard by the high interest rates. In most industries, where our members are employed, at best, they are not hiring and at worst, they have been and are currently laying off many good experienced employees. I am told by our people that interest rates are one of the primary reasons.

High interest rates, resulting from the monetary policies of the Federal Reserve Board are counter-productive as weapons in the fight against inflation. They are inflicting both long and short term damage to the economy without reducing the inflationary forces of energy, food, housing and medical care. Rather, one of the leading sources of inflation is the high interest rates that add to the cost of everything. High interest rates cause particular hardship for small business, home-

buyers, and consumers who, unlike multinational corporations and banks, do not have the ability to shop for credit around the world.

High interest rates and tight money cause the following economic damage:

They increase unemployment, reduce government revenue and increase the cost of social programs.

Interest payments on the federal debt, the fastest rising item in the federal budget, contribute to the deficit and divert funds needed for other vital programs.

Exorbitant interest rates have created a depression in the housing industry. In housing, high interest rates contribute a triple-dose of inflationary pressure; through a housing shortage that drives up prices and rents; through higher purchase prices reflecting the added cost of interest on the construction loans; and through higher monthly payments and rents for the life of the mortgage.

Needed investment in modernization of industry is short-changed as businesses are confronted by 19 percent prime interest rates. Productivity improvements are postponed, perpetuating higher unit costs and impairing the ability of industry to compete. Particularly hard hit have been the steel, automobile and related industries.

High interest rates contribute to higher food prices and the sharp increase in farm bankruptcies.

Tight money encourages capital investment in high-yield but high-risk ventures unrelated to the needs of the economy, including: Financing company take-overs; apartment conversions to condominiums which yield capital gains rather than new housing; financing of gambling casinos and luxury resorts; and speculation in commodities such as the attempt by the Hunt brothers to corner the silver market.

As an anti-inflation policy, high interest rates and tight money can neither reduce the inflationary impetus resulting from world-wide food demands brought on by drought and increased population nor reduce the energy prices dictated by the OPEC cartel.

The Federal Reserve's policies are wasting the capital and human resources, prolonging the recession and aggravating inflation. These policies must be changed and the financial structure adapted to overcome impediments to stable economic growth. In a democratic society, credit policy must not be the exclusive domain of the central bank and its banking constituency.

Credit management measures must be used to allocate available capital resources. The U.S. experience is limited to the spring of 1980 when, for the first time, the Credit Control Act of 1969 was invoked. While there were unfair retroactive changes of outstanding credit arrangements and preemption of some state consumer credit safeguards, the restrictions on total bank credit extensions helped bring the prime rate down from 20 to 11 percent in four months.

Unfortunately, as the economy began its temporary recovery, the credit management measures were rescinded and there was a return to the overall tight money policy.

It is imperative that we turn away from the disastrous reliance on tight money and high interest rates. Specifically we urge the following immediate actions:

1. Channel credit to high-priority areas;
2. Curtail the use of credit by speculators;
3. Limit the extension of credit for overseas ventures;
4. Make the Federal Reserve Board more representative of American society;
5. Encourage use of pension funds for home mortgage loans.

Achieving these goals will require:

A. Making the Credit Control Act of 1969 permanent in order to channel available credit to high-priority areas and to discourage excessive speculation. The Act should be amended to prevent lender abuses in consumer credit and to require the Federal Reserve Board to promptly report to Congress on its credit control policies.

B. Giving the President authority to restrict U.S. capital investment abroad and curb the extension of credit to foreign ventures whenever it is deemed necessary to increase investment in domestic plant and equipment.

C. Amending the Federal Reserve Act to enlarge the Board of Governors to 11 members and broaden its representation to include industry, labor, agriculture and consumers.

D. Encouraging the investment of pension funds in long-term, fixed payment mortgages, with appropriate insurance against loss, in order to help more families purchase housing.

Mr. DAUB. I want to commend you and the persons who helped you with the preparation to bring this information to us on behalf of not only the 300 or so locals in Nebraska, but the half of 100,000,

the 50,000 members, that care not only about their continued potential job security, but their concern about their fellow members who are laid off because of this very problem that we are here addressing today.

If we multiply that one worker times the four to six people who are dependent upon that paycheck, it becomes an even more critical problem for us and that is why we are here.

The first thing you talk about, I believe, is channeling credit to high priority areas.

What do you envision those areas to be, homebuilding, cars, or more of the construction industry like punch plate assembly, cable plant at Western Electric, UP Shop?

Where are you headed with the credit channeling that you are talking about? Would that be the hard sector or soft sector?

Mr. McDONALD. Those things or places that you have mentioned certainly deserve a priority.

Also, I am not sure if it is in effect now, but at one time there was a productivity commission or productivity board, reindustrialization boards set up. I think that it was initiated under the Carter administration.

I am not sure if it is in effect or how active it is right now, but supposedly part of the purpose or the full purpose of that was to pinpoint the different industries that need help the most.

That, along with those that you mentioned, would be high priority areas.

Mr. DAUB. I don't recall, I remember something just exactly what you said is right, but now where it is or what it does any more, I don't know. If you can find out, I would appreciate that.

It could be a vehicle for this. I would not be knowledgeable with respect to indicating to you how the Government could channel credit, but maybe some of the laws that we pass in the near future could help to attract as if there were a magnet, as opposed to shoving the money into the hard sector where jobs are created.

Mr. McDONALD. Yes.

Mr. DAUB. Account reformation means lower interest rates perhaps, but it is only if inflation stays down below 10 like it is now.

The problem we are all worried about is, is it going to stay down?

We have heard other testimony, the bank testified that the negative net worth just shoves interest rates even higher because they have got fewer dollars to lend more people; a lot more money, and they have just got to keep the cost down.

I think that the ability too of Government to channel it may not be so easy but the only opportunity we might have is to attract the money to the right industries, instead of to shove it at them.

The problem is right now that it is an economy where the Mom and Pop store is about the only one that can afford to open its doors any more, because anybody that wants to build mortar blocks just can't get into the business.

The money isn't there. It is a hard sector. They employ more people; don't they?

The homebuilder is a better example.

Maybe No. 5 connects to No. 1. You are willing or your membership seems to be willing to get into this.

I read something about it.

Mr. McDONALD. They do and I have got several articles and I am forwarding to your office some of them, but there are—for years and years, and I was a trustee of, then, a pension plan for quite a few years, and I am presently in my job—but for years all of the trustees, union trustees and the management trustees, simply turned the portfolio over to the person that could bring in the biggest return on that.

There is a lot of thinking in the industry, and my own personal thinking now, that we need to make that available locally to start projects up that will in turn produce work and also in turn put our members to work with pension contributions back into the fund.

In other words, that is an area that we ought to be looking at on that and there are several local unions that are looking at that.

Mr. DAUB. Federal law amendment may be necessary to allow the fund under ERISA to make that kind of an investment.

Mr. McDONALD. Currently there are some places doing that. One of them that I can think of in particular is San Diego, the San Diego area.

ERISA's prudent policy, as you know, while they have taken 5 percent of the funds' assets and put that to work into that type of a thing, and apparently that has satisfied the ERISA requirements——

Mr. DAUB. That is a commercial building contract, right, in San Diego?

Mr. McDONALD. And homebuilding.

Mr. DAUB. Did they do some homebuilding in San Diego?

Mr. McDONALD. I am sure that homebuilding and commercial were part of that.

Now I guess what I am bringing your attention to is that maybe ARISA or something needs to be amended to allow a larger portion of that to be able to do it.

Mr. DAUB. We have some rules now, you know, under ERISA, like the companies own the profit sharing or pension and that was at 10-percent rule, if the company's own stock is part of the corpus of the trust.

If the company has trouble and more than 10 percent is the company's own stock, so the 5- or 10- or 12-, or 15-percent rule might be a good or a guideline that could be worked up.

I particularly think that it is important, because I think that it is a challenge again.

You are sitting over here now maybe being traded up and down as the market does on Wall Street, and your fund might just be better off if you, in the future, if some actuary would talk to this a little bit more, might be better off investing it in land, buildings and jobs and the repayment cycle which caused all of that—than owning some stock in an aircraft or a chemical plant and seeing it traded up and down like a yo-yo.

One year there is a payoff and the next year you lose the same amount because of the managers and the—it is a possibility.

I like that. I am attracted by that.

How would you curtail use of credit by speculators?

Are you talking about a commodity straddle here or are you talking about——

Mr. McDONALD. What I am making reference to is the absurdity of something like the Conoco acquisition.

Mr. DAUB. $10 billion being sucked out of the rent market.

Mr. McDONALD. $10 billion being sucked out of the economy that small businesses especially cannot get and do not have the capacity to get by that.

That type of action I think——

Mr. DAUB. Without creating any more jobs, right, not another job was created in that process?

Mr. McDONALD. That is correct.

Mr. DAUB. We may——

Mr. McDONALD. I think you may be doing nothing whatsoever to increase employment.

Mr. DAUB. What about the limitation of the extension of credit for overseas ventures now? Are you thinking of kinds or are you thinking of less than subsidized kinds of loans that we pay for when we do it?

Mr. McDONALD. I am thinking about the subsidized loans and also the credit that might then go to a specific industry in this country that needs help.

Mr. DAUB. This counterproductive that is actually anticompetitive with industry like nuts and bolts?

Mr. McDONALD. Yes.

Mr. DAUB. Or steel or——

Mr. McDONALD. Yes.

Mr. DAUB. I would ask you, because it is the subject of debate today, what should Government do or not do with respect to that kind of regulation, barriers, tariffs, quotas, add dollars to taxes.

Are you saying avoid that and go after just then how the money leaves our shores?

Mr. McDONALD. I am not a strict protectionist on the thing, but I feel that the way we are being treated by some other countries that there ought to be at least equal treatment in the United States on imports and so on.

Mr. DAUB. There was an interesting thing, was it Gramm-Latta II or the reconciliation where we had the defense appropriation where we were not going to allow taxpayers' dollars in defense expenditures to be used to buy German or Japanese trucks for the Army any more.

Limitation actually was transacted, you know, keep the money here, for that particular purpose, instead of buying their trucks for the Army for defense dollars, they are going to buy American-made trucks.

Mr. McDONALD. I salute you.

Mr. DAUB. Very unique, very different, I voted for that, so it would work, I am sure, in that particular amendment, interesting kind of concept.

Is that what you are trying to get at?

Mr. McDONALD. Yes, that is part of it.

Mr. DAUB. The Federal Reserve Board more representative was elaborated on in your statement when you talked about achieving a goal?

Mr. McDONALD. Yes.

Mr. DAUB. Use the same method of selection but just expand the Board and still keep the Fed independent.

Mr. MCDONALD. Well, that would certainly be an improvement. I am not sure that the Board needs to be entirely independent as it is, but by increasing some members of those groups that I mentioned in there, that would certainly be helpful.

Mr. DAUB. You sure came prepared with specifics. I think they are all positive considerations worth this committee's time and for us, not only to have in the record, but for us to share with our colleagues for a very immediate consideration, I want you to know, not next year or the year after. It is appreciated.

Congressman, do you have something that you would like to ask?

Mr. BEDELL. I think so.

One of the problems it is said that we face is that we compete with Germany and Japan. Particularly, in those two countries labor, management, and Government tend to work together, whereas here all three tend to sort of fight each other.

Do you have any idea what labor's attitude would be toward the productivity or a productivity committee consisting of, say, three representatives of labor and three of business and three of Government at the national level? How would labor look at such an effort, do you know, sir?

Mr. MCDONALD. To solve the problems that we are talking about here or productivity?

Mr. BEDELL. Directed toward, completely toward, productivity.

For instance, let me tell you the concern I have. The concern I have is that it appears in terms of productivity we are losing ground, particularly with the Japanese, greatly because of the fact that the Japanese are further ahead and are simply automating their factories to a greater extent than in the United States and are willing to make investments.

If we sit and let this continue to happen, they are going to continue away from us and take more and more of the world markets that exist.

I guess the question is that historically workers in the United States felt that it was their job to that extent to be combating to keep industry from taking advantage of labor.

At least I think that there is some reason to believe at this time that the cooperative attitude that exists in Japan in particular or in the Government is to see that money is available and helps to see that it is where they need it and where they don't fire their employees and where their employees and—you know, I was in Tokyo and at a restaurant, and they all were wearing black armbands.

I asked somebody, what are those black armbands, and they said, they are on strike. They certainly didn't mean anything else. Our labor would have a little bit of trouble if they wore black armbands to go on strike.

But what I am saying is that I think that they are working together and we are having trouble because of that.

My question is, do you know how labor would look at it—the effort by the Government to try to see if we can get labor and management and the Government to sit down together to address a problem which I think is a very serious problem?

Mr. McDONALD. Congressman, I agree with what you are saying on that. Personally, I would be in favor of such a try.

I am not sure what the national AFL–CIO's position is on that. I was trying to recall; I think there was a three-party group. I was just talking about it, it goes back to your first comment, but I don't know, I think it is dormant right now, because of the failure to appoint people for something——

Mr. DAUB. Yes.

Mr. BEDELL. The President wouldn't have anything if he was going to do that——

Mr. McDONALD. May I say something else about productivity? Of course, that is a long and involved situation, too, and I know that labor has been blamed for declining productivity through the last few years—but you can get all types of figures on this, but I have read a lot of figures that show the last 10 years, that over that, labor has increased productivity 6 percent, but because of the hiring of white-collar people, for instance, don't contribute that much to the work force.

By this hiring of many of those people, actually, the total productivity is lost because of that. Now, I am sure that the business people, I think, have a different story on it, but I think——

Mr. BEDELL. No, that is part of it, but part of it is that it takes significantly fewer labor man-hours to build a car in Japan today than it does in the United States, and that is because of the tooling and automation and use of the robots, that sort of thing, in Japan. That is the adjustment they have made in their plans to do that.

If that continues, we are going to have a hard time selling cars in competition with the Japanese, unless we do some of what they are doing which means more investment and—

Mr. DAUB. I would think that my statistical analysis, and I think it is unfair to be combining the two, I find a positive productivity factor per man-hour from the skilled and semiskilled for blue collar.

I find a negative on the white-collar side, but then you have got to break that down; you have got to know whether it is an insurance industry, building full of 6,000 people, or pushing paper, or whether it is another kind of a business that is categorized as white collar; that is where they are not building buildings, laying brick, or punching something on a die cutter press.

So I think what is really important is that we are automating on the white-collar side, too, with computers and we have got to look ahead then and the productivity council or board or something in that term might be useful not so much because we compete anymore, but maybe because we are starting to look at what our labor markets are going to look like 10 years from now; instead of next year and the high cost interest rates.

Then maybe we will start saying, what kind of jobs are we going to need when our population, 20 percent of it, gets to be over 65, in 1992?

Start thinking ahead so that we start to move our whole economy in a more cooperative way toward the financing base for capital and then the educational base that starts to supply to the worker, to reeducate him, get him in the right direction, just almost like the population shifts from the East because of declining jobs, to the

Sun Belt where construction is booming or to the shale fields of, I think, Montana or Idaho.

That is what I think that Congressman Bedell is getting at—some way to start sitting down together and looking ahead, instead of tomorrow.

Mr. McDONALD. I think that it is a good idea.

Mr. DAUB. I appreciate very much the contribution you made, on behalf of your membership and our State and community. Thank you.

Thank you for coming, for being patient.

Do you have any further questions?

Again, thank you very much.

Mr. McDONALD. Thank you for inviting me.

Mr. DAUB. Mr. Alvin Goodwin, come up and be seated.

You are on. We will spend just a few minutes, because I know you are late and then Ed Miller and Red Keenan will be next and then George Garnett, who I don't see him yet, and then Dick Parrish and then are three others who came that we don't have on the schedule?

I know Wade German's testimony because of his illness, will be in writing. OK.

Welcome, Mr. Goodwin.

For the record, you know that I will not swear you in, because of the discussion of interest rates being one very difficult to place in terms of do you solemnly swear to tell the truth, the whole truth, and nothing but the truth.

TESTIMONY OF ALVIN M. GOODWIN, JR., PRESIDENT, OMAHA ECONOMIC DEVELOPMENT CORP., AND TREASURER, COMMUNITY EQUITY CORP. OF NEBRASKA, AND MEMBER, COMMUNITY BANK OF NEBRASKA BOARD OF DIRECTORS

Mr. GOODWIN. Thank you.

Mr. DAUB. Go right ahead, sir.

Mr. GOODWIN. I have a prepared statement which is before you so I will try to be brief and just capsulize some of my thoughts and comments regarding interest rates.

[Mr. Goodwin's prepared statement follows:]

PREPARED STATEMENT OF ALVIN M. GOODWIN, JR., PRESIDENT, OMAHA ECONOMIC DEVELOPMENT CORP.; TREASURER, COMMUNITY EQUITY CORP. OF NEBRASKA; AND MEMBER, COMMUNITY BANK OF NEBRASKA BOARD OF DIRECTORS

Mr. Chairman, my name is Alvin M. Goodwin, Jr., I am President of the Omaha Economic Development Corporation, Treasurer of Community Equity Corporation of Nebraska and member of the Community Bank of Nebraska Board of Directors.

The Omaha Economic Development Corporation is a non-profit, federally designated community developed corporation. Our corporation sponsors economic and community betterment projects for the benefit of disadvantaged residents who reside in an economically deprived area of North Omaha. Our service area encompasses approximately 11,198 acres and has a population of 51,225. The bottom line of our activity is directed towards creating/expanding economic enterprises which have the capacity to provide meaningful job opportunities and income for residents of our service area.

The Community Equity Corporation of Nebraska is a for profit Minority Enterprise Small Business Investment Company or 301(d) company, located in Omaha, Nebraska, that specializes in investing in minority owned small businesses. The MESBIC program is designed to assist economically and socially disadvantaged persons enter the economic mainstream through small business ownership and management. This is achieved through a partnership between the private sector and

federal government. Essentially, the private sector's profit motive is coupled with the fact that the MESBIC's private capital is at risk before the federal government leverage funds are exposed.

The Community Bank of Nebraska is a minority owned State Chartered bank which began operations in 1974.

I appear before you today to discuss the impact of escalating interest rates on small business owners in our community. In view of the fact that most of our lending activity is directed toward businesses owned by economically and socially disadvantaged persons, I am particularly alarmed by the adverse effects of escalating interest rates for disadvantaged members of our community and state.

In the years 1976 thru 1979 many new minority businesses were started. The creation of new, and the expansion of existing minority business was directly attributed to the direct financial support and loan guarantee programs sponsored by SBA, along with financial assistance from Minority Enterprise Small Business Investment Companies, such as the Community Equity Corporation of Nebraska. In addition, there has become a greater awareness on the part of regular lending institutions that minority business is good business and should not be overlooked.

Minority business has always experienced difficulty in obtaining loans and equity investments. In the last year it has become almost impossible to obtain financial assistance due to escalating interest rates. Most small businesses work with tight profit margins and shortcash positions. Borrowing money to cover short-term cash needs and long-term financial needs with interest rates at current levels place minority businesses at a great disadvantage.

Bankruptcy of minority businesses in the last year, according to SBA, has increased twofold. This can be attributed to a large extent to the inability to finance operations at the present high interest rates. Many business opportunities are passed up by minority entrepreneurs because they cannot support the high interest rates that are required in this tight money market. Opportunity lost is another factor which many times is overlooked. Many new and feasible business opportunities, in a more favorable economic environment, have been presented to our organization which we cannot assist in developing because of tight money brought on by the high interest rates and the difficulty in projecting short-term success because of the high interest rates.

Our investment activity has been severely crippled due to current interest rates. While Omaha Economic Development Corporation and Community Equity Corporation of Nebraska is socially responsive to the needs of our clients, we obviously must maintain an acceptable rate of return on assets in order to continue the service offered. In view of the methods by which our organization generates capital for loan/equity purposes, we can provide business financing at below market rates and still make satisfactory contributions to capital and surplus. While our interest rates remain far below what must be expected in an unsubsidized market environment, the rates to our clients have approached the point that we are experiencing a marked decrease in clients seeking financial support. In this current inflationary economy, disadvantaged business owners simply cannot afford to borrow, even at the attractive rates offered by our organization. I am confident you see the devastating effect on our clients, if it was necessary to obtain financing at competitive rates.

Small businesses account for two-thirds of the jobs and 40 percent of the Gross National Product in our economy. Businesses owned by disadvantaged individuals are major employment markets for capable minorities who may otherwise not be hired. The effects of escalating interest rates on businesses owned by disadvantaged persons is a double-edged sword. The one edge cuts away at the life line of these businesses and threatens its existence, while the other edge cuts away existing and potential employment opportunities for minority group members. Unemployment is a serious problem and it is particularly pressing for minorities in our community. Without a viable minority owned business community, meaningful job opportunities for socially and economically disadvantaged persons will be lost. A further deterioration of employment opportunities cannot be tolerated in this community.

The survival of the small business community and particularly, those small businesses owned by disadvantaged individuals, is threatened due to escalating interest rates. The current rate of interest is the culprit which has led to the near collapse of the housing industry in our community and across the Nation. The majority of small business, particularly minority owned small business, cannot finance inventories, let alone capital improvements at the current interest rates and may soon follow the fate of the housing industry. A tax cut will mean little to small business owners who make no profit to be taxed or discontinue operations because of exorbitant interest rates. If the high interest rates continue, the administrations supply-side economics will obviously be placed in jeopardy.

Minority businesses are in the same position as the black employee in a recession economy—the last to obtain financing and the first to be foreclosed.

In conclusion, I would recommend that the Administration hold a domestic economic conference for the purpose of reducing interest rates and its adverse effect on small businesses . . . particularly those businesses owned by minority group members.

I appreciate the opportunity to appear before you today and would be happy to answer any questions.

Mr. DAUB. Please proceed.

Mr. GOODWIN. For the record, my name is Alvin M. Goodwin, Jr. I am the president of the Omaha Economic Development Corp., treasurer of Community Equity Corp. of Nebraska, and member of the Community Bank of Nebraska board of directors.

The Omaha Economic Development Corp. is a nonprofit, and federally funded designated community developed corporation, rather, development corporation, really seeking to provide jobs and income for residents of a geographic area that I serve.

The Community Equity Corp. of Nebraska, of which I am the treasurer, is a minority enterprise small business investment company or corporation, licensed about 4 years ago. We had private aid and capital of about $500,000.

The bank, obviously, is a minority-owned bank located in Omaha, chartered in 1974.

I appear before you today to discuss the impact of escalating interest rates on small business owners in our community.

In view of the fact that our lending activity is directed toward businesses owned by economically essentially deprived persons, I am particularly alarmed by the adverse effect of such escalating interest rates for disadvantaged members of our community and State.

In the years 1976 to 1979, many new minority businesses were started. The creation of new then and the expansion of existing minority businesses was directly attributed to the direct financial support and loan guaranteed programs sponsored by the Small Business Administration along with financial assistance from MESBIC's such as the Community Equity Corp. of Nebraska.

In addition, there has been a greater awareness on the part of regular lending institutions and other lending institutions that minority business is good business and should not be overlooked.

Minority business has always experienced difficulty in obtaining loans and equity investments. In the last year, it has become almost an impossible thing to obtain financial assistance due to escalating interest rates.

Most small businesses work with tight profit margins and short cash positions, borrow money to cover short-term cash needs and long-term financial needs and with interest rates at present levels, that places minority businesses at a great disadvantage.

Bankruptcy of minority business in the last year, according to SBA, has increased twofold. This can be attributed to a large extent to the inability to finance operations at the present high interest rates.

Many business opportunities are passed up by minority entrepreneurs because they cannot support the high rates that are required in this tight money market.

Opportunity lost is another factor which is somewhat overlooked and many feasible business opportunities in a more favorable economic environment have been presented to our organization which we cannot assist in developing because of tight money brought on by the high interest rates and the difficulty in projecting short-term success because of the high interest rates.

Our investment activity has been severely crippled due to current interest rates.

While both organizations are socially responsive to the needs of our clients, we, obviously, must maintain an acceptable rate of return on assets in order to continue the service offered.

While our interest rates remain far below what must be expected in an unsubsidized market environment, the rates to our clients have approached the point that we are experiencing a marked decrease in clients seeking financial support.

In this current inflationary economy, disadvantaged business owners simply cannot afford to borrow, even at the attractive rates offered by our organization.

I am confident you see the devastating effect on our clients, if it was necessary to obtain financing at competitive rates.

Small businesses account for two-thirds of the jobs and 40 percent of the gross national product in our economy. Businesses owned by disadvantaged individuals are major employment markets for capable minorities who otherwise may not be hired.

The effects of escalating interest rates on businesses owned by disadvantaged persons are a double-edge sword. The one edge cuts away at the lifeline of these businesses, and threatens its existence while the other edge cuts away existing and potential employment opportunities for minority group members.

Unemployment is a serious problem and it is particularly pressing for minorities in our community.

Without a viable minority-owned business community, meaningful job opportunities for socially and economically disadvantaged persons will be lost.

A further deterioration of employment opportunities cannot be tolerated in this community.

The survival of the small business community and particularly those small businesses owned by disadvantaged individuals is threatened due to escalating interest rates.

The current rate of interest is the culprit which has led to the near collapse of the housing industry in our community and across the Nation.

The majority of small businesses, particularly minority-owned small businesses, cannot finance inventories, let alone capital improvements, at the current interest rates and may soon follow the fate of the housing industry.

A tax cut will mean little to small business owners who make no profit to be taxed or discontinue operations because of exorbitant interest rates.

If the high interest rates continue the administration's supply side economics will, obviously, be placed in jeopardy.

Minority businesses are in the same position as the black employee in a recession economy, the last to obtain financing and the first to be foreclosed.

In conclusion, I would recommend that the administration hold a domestic economic conference for the purpose of reducing interest rates and its adverse effect on small business, particularly those businesses owned by minority group members.

I thank you and I will answer any questions that you have.

Mr. DAUB. You are going to get them. I am ready and I appreciate not only the thoughtfulness of your presentation, but its sensitivity to a growing concern.

On the airplane coming out this morning, Al, I read not only about the crushing cost of money, not only about the prime rate, not only about the interest rates are still stuck on high, the sky-high interest rates, just article after article, and one of them that I came to talked about the impact not only of interest rates on small business, which is fairly disproportionate, because they can't collateralize——

Mr. GOODWIN. Absolutely.

Mr. DAUB. But, anyway, the impact on the socially disadvantaged minority enterprise, particularly, Congressman Bedell and I, he is absent only to greet our representative of the Federal Reserve Board from Chicago, who is now arriving and will be here with us in a few minutes.

We find that the programs of MESBIC, and SBA loan guaranteed programs, are going to be reduced. That will be the direct and indirect lending programs even if we continue to subsidize the rate at market which is 13 or 14 versus 20 on the outside, as you said, if you tried to get it in the free market, in the competitive market, would hardly be any different.

The minority enterprise is one that is not able to collateralize his loan.

Mr. GOODWIN. Absolutely.

Mr. DAUB. I want to know from your own knowledge, if you have it, are there any businesses closed in the north Omaha area?

Mr. GOODWIN. Within the last year, we have experienced a number of businesses that we are familiar with by being familiar and being in a lending position, we have copies of financial statements, so we know the integral workings of many of the minority businesses.

Mr. DAUB. Six, eight, ten, twelve?

Mr. GOODWIN. There has been——

Mr. DAUB. Just approximately.

Mr. GOODWIN. Just based on SBA figures, there has been a twofold increase in bankruptcies and closings.

Mr. DAUB. In this area?

Mr. GOODWIN. In this area.

I would say that there have probably been 20 to 25 businesses within the last——

Mr. DAUB. How many jobs would that be?

Mr. GOODWIN. Within the last year.

Mr. DAUB. Is that 200, 500 jobs, or what?

Mr. GOODWIN. If you took it on an average of three jobs, you are talking somewhere between then 70 and 75.

Mr. DAUB. Are they homebuilders? Are they rehabers?

Mr. GOODWIN. Most of them in our community are in contracting or service and retail kinds of activities.

Mr. DAUB. What do you think we need to do to reduce the cost of money?

Mr. GOODWIN. You have asked other people that and that is extremely difficult, a difficult situation. I don't think that you can say that it is one that you can do this, that or the other.

I think that you have to look at ~~both the~~ monetary policies that are being proposed now and the fiscal policies in order to solve the interest rate problem.

As an example, you can't have increased economic growth, reduced interest rate, and reduced levels of inflation at the same time.

These are somewhat contrary to economic principles and this is why I would propose that I think the problem has escalated to the point that it is so serious that on a national level you need a domestic economic conference.

Mr. DAUB. I think that is a very positive suggestion.

It would be somewhat like the White House Conference on Small Business, but this time focusing on the economy?

Mr. GOODWIN. Absolutely.

Mr. DAUB. What about with respect to the socially disadvantaged business person funding MESBIC's at a higher level than they have been funded, since it may be more job-related or on the supply side thing, it could be, isn't it a very logical supply side ingredient?

Mr. GOODWIN. It is a logical supply side ingredient but with——

Mr. DAUB. Can you absorb how to use the money?

Mr. GOODWIN. Absolutely. We can use it if we can get it and place it at rates that are attractive.

Mr. DAUB. What is a good rate?

At 12 again, could you make it at 12 percent?

Mr. GOODWIN. To give you a good example, we borrow right now at three points under what the Government paid for money in August. It was 14.875. We get it at three points under so that is 11.875.

We have administrative costs we are not looking at. You have got to get it somewhere in the 12- to 14-percent range, but you still get into a dangerous situation.

Even if interest rates drop to 10 percent, can we afford the millions of people that might be placed on unemployment programs?

Mr. DAUB. This is what I said in my opening statement, that you can do all of those things to remanage, but the price we pay for that, in terms of long-term damage, may be an intolerable price to pay.

I really appreciate your comment for the record.

Congressman Bedell, did you have anything?

I appreciate your time and partiuclarly the time to give us your written testimony which I think has been well framed.

Mr. GOODWIN. Thank you.

Mr. DAUB. We would like to call next Ed Miller of Minuteman Printing and Mr. Red Keenan of Keenan Equipment, together.

It appears that you are going to join us.

We would like you to take into account the fact that the Federal Reserve did arrive and they are being interviewed now, or we are

in a tight bind, so we want to thank you for your patience and hope that you can kind of really help us move along too, OK?

Gentlemen, we are pleased to have you here. Is there a way of determining who goes first?

Mr. MILLER. I capitulated. Red may go first.

TESTIMONY OF RED KEENAN, KEENAN EQUIPMENT, INC.

Mr. KEENAN. My name is Red Keenan, Keenan Equipment.

I brought along for the record something that you might want to enter. It is not a written statement, but it is 3 years of financial statements with two recent bills for interest. I will just go through it very briefly with you.

[Material referred to above follows:]

Koehring Finance Corporation
A Koehring Subsidiary
Milwaukee, Wisconsin 53201

MISCL. BILLING NO. [illegible]

DATE 7/14/84

Remit To: KOEHRING FINANCE CORPORATION
P.O. Box [illegible]
CHICAGO, ILLINOIS 60693

DEBIT KEENAN'S EQUIP ENT INC
251 W 84TH ST
OMAHA
NE 68134

PAGE

SERIAL NUMBER = 110074

INTEREST DUE AS FOLLOWS:

04/14/84 TO 09/25/84	[redacted]	$37,304.00	$966.13
			$966.13

A 2% PENALTY WILL BE IMPOSED ON ALL ACCOUNTS MORE THAN 30 DAYS OVERDUE

BEST COPY AVAILABLE

FIRST WEST SIDE BANK
FIRST WEST SIDE BANK COMMERCIAL LOANS -

SEP 22 19[illegible]

OFFICE [illegible]-01 LOAN INTEREST AND PRINCIPAL BILL
CUSTOMER NUMBER 2249921025 DATE 09-18-81 PAGE 1

OBLIGATION NUMBER	EFFECTIVE DATES FROM	EFFECTIVE DATES TO	PRINCIPAL BALANCE	ANNUAL PERCENTAGE RATE	AMOUNT DUE	CHARGE TYPE	YEAR TO DATE INTEREST(FEES)
00091	06 22 81	07 27 81	1500000	21.00	13000	INT	
ANNUAL PERCENTAGE RATE			15 21.00				
	07 28 81	08 27 81	1500000	21.00	12452	INT	
ANNUAL PERCENTAGE RATE			15 21.00				
	06 22 81	08 27 81			1500000	PRIN	

PLEASE DETACH AND RETURN THIS PORTION OF BILL WITH PAYMENT

FIRST WEST SIDE BANK
FIRST WEST SIDE BANK COMMERCIAL LOANS

OFFICE 91001-01 LOAN INTEREST AND PRINCIPAL BILL

TO AVOID ADDITIONAL CHARGES PAYMENT
MUST BE MADE BY DUE DATE 09-28-81

KENMAN EQUIP
2611 NO 84TH
OMAHA NE 68134

PRINCIPAL DUE	15,000.00
INTEREST/FEE DUE	802.00
TOTAL AMOUNT DUE	15,802.60

2249921025 0011 0007150802[illegible] 81092805

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KEENAN'S EQUIPMENT, INC.

BALANCE SHEET

Month ending August 31, 1981

ASSETS

URRENT ASSETS

Cash	20,462.54	
Savings	41.32	
Accounts Receivable	46,926.59	
Rent Deposit	1,364.00	
Reserve for Bad Debts	<4,000.00>	
Equipment Inventory	284,461.60	
Prepaid Insurance	3,148.50	
Parts Inventory	50,075.48	
Salesman Advance	200.00	
Rental Equipment (Inventory Acct.)	168,650.86	
TOTAL CURRENT ASSETS		574,650.89

THER ASSETS

U.P.S. Deposits	90.00	
Lease Deposits	900.00	
Ofcr. Life Ins. Cash Sur. Value	8958.99	
TOTAL OTHER ASSETS		9,948.99

ROPERTY

Furniture & Fixtures	10,980.78	
Cars & Trucks	75,384.61	
Shop Equipment	4,798.25	
TOTAL PROPERTY	91,163.64	
Accumulated Depreciation	<68,812.84>	
NET PROPERTY		23,350.80

TAL ASSETS 606,950.68

KEENAN'S EQUIPMENT, INC.

BALANCE SHEET

Month ending August 31, 1981

LIABILITIES

CURRENT LIABILITIES		
ACCOUNTS PAYABLE	69,560.83 *	
ACCRUED REAL ESTATE & P.P. TAX	4009.58	
ACCRUED PAYROLL	1770.39	
ACCRUED INTEREST	3380.27	
SALES TAX (NEBRASKA)	944.35	
SALES TAX (IOWA)	389.28	
SALES TAX (KANSAS)	<31.40>	
CORPORATE INCOME TAX	<2095.11>	
ACCRUED PAYROLL TAX	549.26	
TOTAL CURRENT LIABILITIES		~~79,665.47~~ 754.85 25
OTHER LIABILITIES		
FLOOR PLAN	126,173.99	
		126,173.99
NOTES PAYABLE		
F.W.S. BANK - SBA	86,996.28	
F.W.S. BANK - MISC.	65,743.24	
CONWAY KEENAN	11,270.00	
ATO	34,566.62	
C.I.T.	19,278.38	
LEASE PURCHASE - RELI	7,261.58	
LEASE PURCHASE - CUSTOM/OTOE	3,498.67	
LEASE PURCHASE - METRO LEASING	26,196.38	
LEASE PURCHASE - I.C.I.	8,000.00	
BORG WARNER	8,825.00	
ELMA CANTERBURY	3,500.00	
TOTAL NOTES PAYABLE		368,509.15
TOTAL LIABILITIES		

OWNER'S EQUITY

KEENAN'S EQUIPMENT, INC., CAPITAL		
CAPITAL STOCK	20,000.00	
RETAINED EARNINGS	88,122.44	
NET INCREASE/DECREASE	<61,379.15>	
CAPITAL		46,743.29
TOTAL LIABILITIES & OWNERS EQUITY		606,950.62

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KEENAN'S EQUIPMENT, INC.

PROFIT & LOSS STATEMENT

MONTH ENDING August 31, 1981

MONTH TO DATE	YEAR TO DATE	DESCRIPTION
30,478.88	126,368.21	EQUIPMENT SALES - LAWN & GARDEN
.00	92,535.00	TRAC-WELD
36,651.20	315,714.76	HIGH REACH SALES
10,825.10	73,966.85	PARTS SALES
6,019.00	77,301.25	RENTAL INCOME
4,267.64	16,307.13	DELIVERY & FREIGHT INCOME
80.82	1,140.08	GAS & OIL INCOME
6,875.57	31,306.86	SERVICE INCOME
.00	2,731.43	MISCELLANEOUS INCOME
173.58	7,439.36	WARRANTY INCOME
.60	4,238.86	DISCOUNTS EARNED
5.27	2,299.77	MARKETING
<626.95>	120.55	RESTOCKING FEE
		KUBOTA DISCOUNT
96,900.71	743,459.11	TOTAL INCOME
		COST OF SALES
24,131.21	101,824.96	LAWN & GARDEN
.00	66,565.03	TRAC-WELD
28,808.36	273,469.67	HIGH REACH
6,634.14	48,109.44	PARTS
287.80	6,025.39	SERVICE
522.64	4,032.92	RENTAL
60,384.15	500,027.41	TOTAL COST OF SALE

4,319.88
NET INCOME/LOSS, MONTH TO DATE

<61,279.15>
INCOME/LOSS YEAR TO DATE

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KEENAN'S EQUIPMENT, INC.

PROFIT & LOSS - EXPENSES

MONTH ENDING August 31, 1981

MONTH TO DATE	YEAR TO DATE	DESCRIPTION
457.22	5,092.34	COMMISSIONS
2,032.00	21,220.00	SALARIES, OFFICERS
1,357.32	18,847.27	SALARIES, SALES
2,850.25	24,999.45	SALARIES, OFFICE
4,091.49	38,301.28	SALARIES, SERVICE
1,020.11	10,798.05	SALARIES, PARTS
286.39	1,179.70	RE-DO SHOP
.00	394.89	SERVICE SCHOOLS
.00	.00	JIM POTTER - REIMBURSEMENT
.00	3,250.00	ACCOUNTING
1,398.67	4,653.62	DELIVERY & FREIGHT
396.5	4,785.80	GAS & OIL
42.54	575.49	DUES & SUBSCRIPTIONS
1,750.00	8,750.00	RENT
175.55	8,800.97	WARRANTY
.12	1.62	DISCOUNTS ALLOWED
<747.60>	.00	BID BONDS
785.23	9,075.59	F.I.C.A./PAYROLL TAXES, U.C.F.
.00	371.76	TAXES, SALES ON LEASE PURCH.
495.23	1,075.84	TAXES, REAL ESTATE & PERS. P.
5,969.01	93,386.95	INTEREST
16.00	28.33	BANK CHARGES
273.94	4,287.97	VEHICLE EXPENSE
<84.39>	5,122.69>	RESTOCKING FEES
1,178.68	14,910.02	ADVERTISING
448.66	5,362.87	TRAVEL
148.32	892.16	OFFICE
198.13	1,345.85	TELEPHONE
387.91	3,364.81	UTILITIES
172.48	2,230.56	SHOP EXPENSE
.00	435.64	MOTOROLA - 2 WAY RADIO
205.00	1,203.50	LEASE EXPENSE
.00	96.25	CONTRACT LABOR
2,254.00	21,955.00	DEPRECIATION EXPENSE
961.06	9,461.36	INSURANCE, MISCELLANEOUS
412.84	3,887.62	INSURANCE, GROUP
73.86	418.62	MISCELLANEOUS
80.04	1,183.21	ENTERTAINMENT & PROMOTIONS
.00	10.50	DONATIONS
25.81	247.89	POSTAGE
.00	262.50	UNIFORMS
.00	.00	BAD DEBTS & CHECKS
55.50	398.94	UNITED PARCEL SERVICE
249.21	2,247.87	BUILDING MAINTENANCE
12.66	41.40	CREDIT CARD DISCOUNTS
.00	16.62	PETTY CASH OVER/SHORT
.00	.00	INCOME TAX EXPENSE
30,196.58	304,710.85	TOTAL EXPENSES

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KEENAN'S EQUIPMENT, INC.

BALANCE SHEET

Month ending August 31, 1980

ASSETS

CURRENT ASSETS		
Cash	9,804.03	
Accounts Receivable	122,017.60	
Inventory - Parts	46,005.08	
Inventory - Equipment	420,851.14	
Rent Deposits	1,273.00	
Prepaid Interest	3,270.76	
Equipment Option Purchases	4,100.00	
Salesman Advance	40.00	
Savings FWSB	39.21	
RESERVE FOR BAD DEBT	<1,000.00>	
TOTAL CURRENT ASSETS		605,600.82
OTHER ASSETS		
Organization Expense	.00	
Cash Sur. Value Ofcr. Life	2,406.15	
Lease Deposits	1,593.00	
U.P.S. Deposit	50.00	
TOTAL OTHER ASSETS		9,249.15
PROPERTY		
Furn. & Fixtures	10,831.34	
Cars, Trucks	66,283.16	
Equipment	2,877.15	
Rental Equipment	97,878.29	
TOTAL PROPERTY	177,869.94	
Accumulated Depreciation	<50,062.80>	
NET PROPERTY		127,807.14
TOTAL ASSETS		742,657.11

KEENAN'S EQUIPMENT, INC.

BALANCE SHEET

Month Ending August 31, 1980

LIABILITIES

CURRENT LIABILITIES

Accounts Payable	53,202.76	
Accrued Real & Personal Property	4,540.26	
Accrued Interest	3,642.01	
Sales Tax (Nebr.)	1,865.55	
Sales Tax (Iowa)	171.70	
Corporate Income Tax	(1,986.00)	
Accrued Payroll Tax	615.46	
Lease Purch. Contr. (Custom Lease)	54,132.76	
Installment Purchases ICI	34,025.00	
Lease Purchase Contracts RELI	14,064.88	
Accrued Payroll	.00	
Sales Tax (Kansas)	(50.85)	
Lease Purchase (Metro Leasing)	28,552.21	
TOTAL CURRENT LIABILITIES		192,775.84

OTHER LIABILITIES

Floor Plan	121,598.69	
		121,598.69

NOTES PAYABLE

Conway Keenan	10,510.00	
F.W.S. Bank - SBA	96,296.76	
	59,131.11	
York Bank	.00	
C.I.T.	28,892.94	
BORG - WARNER	27,926.25	
Credit Alliance	.00	
AIO	74,644.39	
TOTAL NOTES PAYABLE		297,401.45

TOTAL LIABILITIES 611,775.98

OWNER'S EQUITY

Keenan's Equipment, Inc., Capital		
Capital Stock	20,000.00	
Retained Earnings	71,089.42	
Net Increase/Decrease	39,791.71	
Capital		130,881.13

TOTAL LIABILITIES & OWNERS EQUITY 742,657.11

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KEENAN'S EQUIPMENT, INC.

PROFIT & LOSS STATEMENT

Month Ending August 31, 1980

MONTH TO DATE	YEAR TO DATE	DESCRIPTION
.00	1,709.98	KUBOTA DISCOUNT UNEARNED
16,875.35	248,131.23	EQUIPMENT SALES - LAWN & GARDEN
30,000.00	416,155.08	HIGH REACH SALES
5,567.67	52,533.60	PARTS SALES
9,699.50	112,361.69	RENTAL INCOME
1,024.37	11,182.43	DELIVERY & FREIGHT INCOME
136.36	1,124.17	GAS & OIL INCOME
3,666.41	29,552.65	SERVICE INCOME
198.00	198.00	~~MISCELLANEOUS INCOME~~ Restocking Fee
1,238.74	4,085.41	WARRANTY INCOME
92.72	3,994.13	DISCOUNTS EARNED
391.00	4,340.83	MARKETING
68,890.12	885,379.20	TOTAL INCOME
		COST OF SALES
24,508.60	330,060.73	HI-REACH C.O.S.
9,433.34	194,189.90	YARD & GARDEN - C.O.S.
3,730.91	35,002.35	PARTS - C.O.S.
841.83	3,171.95	SERVICE COSTS
317.20	5,353.10	RENTAL COSTS
<131.80>	10,696.89	GAIN OR LOSS ON SALE OF EQUIP.
38,700.58	578,474.92	TOTAL COST OF SALES

3,770.14
NET INCOME/LOSS MONTH TO DATE

34,791.71 INCOME/LOSS YEAR TO DAT

KEENAN'S EQUIPMENT, INC.

PROFIT & LOSS - EXPENSES

Month Ending August 31, 1980

MONTH TO DATE	YEAR TO DATE	DESCRIPTION
1,760.00	18,920.00	SALARIES, OFFICERS
2,142.64	19,633.60	SALARIES, SALES
2,605.57	27,921.42	SALARIES, OFFICE
3,391.86	32,344.58	SALARIES, SERVICE
366.68	4,021.59	SALARIES, PARTS
585.06	4,340.80	COMMISSIONS
128.30	631.85	RE-DO SHOP
.00	681.74	SERVICE SCHOOLS
15.00	3,423.20	ACCOUNTING
456.34	3,350.55	DELIVERY & FREIGHT
1,305.68	9,967.54	GAS & OIL
42.54	485.63	DUES & SUBSCRIPTIONS.
875.00	8,750.00	RENT
1,050.55	5,871.26	WARRANTY
11.47	221.07	DISCOUNTS ALLOWED
.00	.00	BID BONDS
665.21	7,146.45	F.I.C.A./PAYROLL TAXES
54.52	670.96	TAXES, SALES ON LEASE PURCH.
115.46	1,772.52	TAXES, REAL ESTATE & PERS.P.
4,446.63	45,567.34	INTEREST
.00	4.68	BANK CHARGES
426.40	3,489.21	VEHICLE EXPENSE
1,392.75	13,112.04	ADVERTISING
52.70	2,856.32	TRAVEL
.00	809.08	AIRPLANE
39.67	1,264.82	OFFICE
893.38	6,117.73	TELEPHONE
252.23	3,022.42	UTILITIES
451.71	3,026.32	SHOP EXPENSE
33.04	456.08	MOTOROLA -2 WAY RADIO
.00	460.66	LEASE EXPENSE
.00	155.66	CONTRACT LABOR
1,571.00	16,110.00	DEPRECIATION EXPENSE
35.00	965.00	INSURANCE, MISC.
295.87	2,598.75	INSURANCE, GROUP
54.86	1,420.00	MISCELLANEOUS
120.26	1,410.51	ENTERTAINMENT & PROMOTIONS
.00	50.00	DONATIONS
60.00	758.78	POSTAGE
18.28	724.24	UNIFORMS
.00	7.54	BAD DEBTS & CHECKS
78.91	488.47	UNITED PARCEL SVC.
243.71	1,581.76	BUILDING MAINT.
1.37	52.73	CREDIT CARD DISCOUNTS
.00	<4.27>	PETTY CASH OVER/SHORT
46.99	1,380.96	J.P. REIMBURSEMENT OF VEHICLE
.00	164.00	INCOME TAX EXPENSE (STATE)
.00	<28.62>	RESTOCKING FEES
26,419.40	267,112.57	TOTAL EXPENSES

KEENAN'S EQUIPMENT, INC.

BALANCE SHEET

Month ending August 31, 19 75

ASSETS

CURRENT ASSETS		
Cash	6,131.73	
Accounts Receivable	67,882.32	
Inventory - Parts	40,180.03	
Inventory - Equipment	344,962.90	
Rent Deposits	1,187.61	
Prepaid Interest	4,282.49	
Equipment Option Purchases	7,150.00	
Salesman Advance	20.00	
Savings FWSB	3243	
TOTAL CURRENT ASSETS		468,736.51
OTHER ASSETS		
Organization Expense	279.84	
Cash Sur. Value Ofcr. Life	6,308.78	
Lease Deposits	1,593.00	
TOTAL OTHER ASSETS		7,901.78
PROPERTY		
Furn. & Fixtures	10,621.34	
Cars, Trucks	98,235.54	
Equipment	2,626.27	
TOTAL PROPERTY	111,483.15	
Accumulated Depreciation	(24,297.04)	
NET PROPERTY		87,186.11
TOTAL ASSETS		563,824.40

KEENAN'S EQUIPMENT, INC.

BALANCE SHEET

Month Ending August 31 1979

LIABILITIES

CURRENT LIABILITIES

Accounts Payable	42,718.29	
Accrued Real & Personal Property	9,240.98	
Accrued Interest	756.81	
Sales Tax (Nebr.)	2,388.69	
Sales Tax (Iowa)	26.65	
Corporate Income Tax	(1,932.00)	
Accrued Payroll Tax	1,060.53	
Lease Purch. Contr. (Custom Lease)	52,867.65	
Installment Purchases	33,362.84	
Lease Purchase Contracts	33,238.88	
Accrued Payroll	2,248.93	
TOTAL CURRENT LIABILITIES		175,773.82

OTHER LIABILITIES

Floor Plan	107,625.60	
		107,625.60

NOTES PAYABLE

Conway Keenan	9,400.00	
F.W.S. Bank - SBA	54,067.85	
F.W.S. Bank - Misc.	30,258.65	
York Bank	4,830.14	
C.I.T.	58,414.73	
I.H.C.C.	.69	
Credit Alliance	.03	
ATO	22,772.99	
TOTAL NOTES PAYABLE		179,876.26

TOTAL LIABILITIES	463,274.78

OWNER'S EQUITY

Keenan's Equipment, Inc., Capital		
Capital Stock	20,000.00	
Retained Earnings	30,221.32	
Net Increase/Decrease	50,328.30	
Capital		100,549.62
TOTAL LIABILITIES & OWNERS EQUITY		563,824.40

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KEENAN'S EQUIPMENT, INC.

PROFIT & LOSS STATEMENT

Month Ending August 31, 1979

MONTH TO DATE	YEAR TO DATE	DESCRIPTION
00	6.99	Restocking Fees
47,450.36	236,511.16	EQUIPMENT SALES - LAWN & GARDEN
28,613.00	300,814.23	HIGH REACH SALES
~~9,397.59~~ 7,377.54	59,196.23	PARTS SALES
241.50	138,284.75	RENTAL INCOME
1,865.82	9,718.79	DELIVERY & FREIGHT INCOME
104.68	1,584.15	GAS & OIL INCOME
4,136.22	59,040.48	SERVICE INCOME
.00	602.04	MISCELLANEOUS INCOME
66.35	4,408.90	WARRANTY INCOME
.00	4,440.94	DISCOUNTS EARNED
710.32	4,957.52	MARKETING
90,585.90	820,014.18	TOTAL INCOME
		COST OF SALES
19,617.54	230,789.79	HI-REACH C.O.S.
38,646.05	192,193.39	YARD & GARDEN - C.O.S.
5,221.04	39,111.53	PARTS - C.O.S.
673.01	24,719.08	SERVICE COSTS
5,282.72	51,248.47	RENTAL COSTS
69,488.36	540,062.26	TOTAL COST OF SALES

<2132.33>
NET INCOME/LOSS MONTH TO DATE

50,308.30 INCOME/LOSS YEAR TO DATE

KEENAN'S EQUIPMENT, INC.

PROFIT & LOSS - EXPENSES

Month Ending August 31, 1972

MONTH TO DATE	YEAR TO DATE	DESCRIPTION
2,200.00	19435.00	SALARIES, OFFICERS
18,568.30	18,501.27	SALARIES, SALES
2,920.62	24,159.42	SALARIES, OFFICE
3,874.73	30,638.38	SALARIES, SERVICE
1,510.69	11,288.59	SALARIES, PARTS
204.75	1,684.20	COMMISSIONS
.00	225.35	RE-DO SHOP
.00	339.59	SERVICE SCHOOLS
.00	1,200.00	ACCOUNTING
809.81	3,523.27	DELIVERY & FREIGHT.
650.43	5,942.00	GAS & OIL
25.00	439.91	DUES & SUBSCRIPTIONS
875.00	8,750.00	RENT
234.64	6,338.22	WARRANTY
.00	1,199.07	DISCOUNTS ALLOWED
.00	25.00	BID BONDS
626.65	6,926.43	F.I.C.A./PAYROLL TAXES
87.50	436.64	TAXES, SALES ON LEASE PURCH.
300.00	7,512.17	TAXES, REAL ESTATE & PERS.P.
3,070.89	(30,774.93)	INTEREST
.00	.66	BANK CHARGES
373.56	5,269.61	VEHICLE EXPENSE
113.32	5,557.61	ADVERTISING
(25.23)	2,054.76	TRAVEL
.00	820.26	AIRPLANE
(15.91)	568.88	OFFICE
409.84	3,444.10	TELEPHONE
167.90	2,991.64	UTILITIES
52.85	2,447.34	SHOP EXPENSE
8.67	785.13	MOTOROLA 2 WAY RADIO
.00	440.42	LEASE EXPENSE
193.60	318.60	CONTRACT LABOR
924.50	8,345.00	DEPRECIATION EXPENSE
277.00	8,761.80	INSURANCE, MISC.
296.93	2,676.22	INSURANCE, GROUP
146.06	279.27	MISCELLANEOUS
146.00	1,070.40	ENTERTAINMENT & PROMOTIONS
.00	.00	DONATIONS
63.22	637.02	POSTAGE
.00	189.37	UNIFORMS
203.04	699.44	BAD DEBTS & CHECKS
44.97	286.51	UNITED PARCEL SVC.
136.03	1,420.69	BUILDING MAINT.
32.51	139.15	CREDIT CARD DISCOUNTS
.00	.00	PETTY CASH OVER/SHORT
23,229.87	229,643.62	TOTAL EXPENSES

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Mr. KEENAN. The top one is a bill that I just got and it is just there to show you that the rate currently is 22 percent on a $37,304 piece of equipment that I have in floor plan.

You can see at 43 days, at that rate, that cost me $966.83. The meter continues to run.

Incidentally, this is a piece of construction equipment that I got in April and it is still new and still on the lot. It is a forklift that is used to reach and to put block up in height, high places.

At this point, there are some 13 of those types of equipment that are sitting idle that I know of in town right now and the chance of mine being sold in the near future is not very good.

In the meantime, the meter keeps running.

Second, I brought along a copy of a recent signature loan that I have at my bank and you will notice that the interest rate is at 21.50.

Then below that are 3 years of financial statements and I would just like to draw your attention to the bottom line, if you go to page 3 of that, I think it has got a No. 3 on it, you will see $61,279.15 in brackets. That is a 10-month operation. That is my loss at this point.

A similar period last year at this time, I had a $50,000 profit. That is basically the bottom line difference in what it costs to do business and operate this year.

Now, let me just give you a couple of things that contributed to that. No. 1, my volume in tractor sales, lawn and garden equipment, went from $248,000 for this period in 1980 to $126,000 this year, a 49-percent decrease.

This is a capital investment that an individual would make to maintain his own property or that a pool or a park or a cemetery would use to maintain their property.

The reason for the great decrease in this is that it is much like the automobile industry; financing this equipment is too expensive for the customers. They continue to use what they have. In the case of grass and wheats, they just don't mow it. They just let it grow.

The second portion of my company is a high reach division, that is, equipment, such as I mentioned before, used to place material and personnel at high heights. Its gross volume was down to 24 percent from last year.

I have a rental division. Its gross volume was down 31 percent.

I have two other pieces of information that might be of interest to you. My interest paid is on the next page. You will see that in the last 10 months, I paid $53,286.95 worth of interest. That is, at this point, 7 percent of my gross sales.

I might say that in 1979. That was 4 percent of my gross sales, my interest was, and in 1980, it was 5 percent. It has jumped to 7 percent of my gross sales.

Now, not so much that the interest, itself, has increased all of that much, but in proportion to my decreased sales volume, it really makes the spread much greater.

During that same period of time, my operating expenses have come up from $267,000 last year to $304,000 to operate the same business.

There are some other things that contribute to that loss that we show this year. Part of it is the cost of gas and oil. Part of it is the cost, the additional cost, of travel and to make the effort to make sales outside of the territory which has been a very flat territory for sales.

We have had to move out a considerable distance from Omaha to try to do our sales. So those 3 years of financial statements will give you the solvent facts. Those are the heart of our company which show really what has happened to us in dollars and cents or in black and white.

I also can just tell you that in terms of personnel costs I put a new salesman on this spring and kept him for 4 months and then had to let him go. The question of whether I will be able to maintain the staff that I have through the winter right now is one we are taking serious study. My guess is that unless things change very soon, we will probably not be able to do that.

The reason for that is that our customer, the homebuilder, particularly, but the industrial client, who would be built to supply the needs of people across the country, just has not expanded and the homebuilder, of course, is doing nothing at all and that is basically what we base our business on.

I would be happy to answer any questions.

Mr. DAUB. I will reserve my questions, until I hear Mr. Miller's testimony.

Would you identify yourself for the record?

Mr. MILLER. Yes, sir.

TESTIMONY OF ED MILLER, PRESIDENT, MINUTEMAN PRINTING

Mr. MILLER. My name is Ed Miller.

I am president of Minuteman Printing.

For this hearing though, I have chosen to wear my other hat. I am active in a number of small business groups, locally, regionally, nationally.

I am Federal legislative chairman of the Small Business Council of Omaha, and a member of the NFIB, NSBA, Mid-Continent Small Business United.

I was in a meeting in Kansas City, last weekend of a group of Mid-Continent Small Business United which includes Kansas, Missouri, Iowa, and Nebraska.

At that meeting, I think I can come back and tell to you that interest rates are, indeed, killing small business and that is beyond question.

In fact, of the 100 or 110 of us who met in Kansas City, 5 to 10 are downright suicidal. They are downright suicidal.

Mr. BEDELL. As individuals, you mean?

Mr. MILLER. As individuals; yes, sir.

They are; they don't have any more. They're trying to survive, not doing well at even surviving, much less improving and progressing.

The consensus and my personal opinion as to the causes, are that the causes did not occur yesterday, last year or the year before last; we would lay them basically to fiscal and monetary policy at the national level.

87-024 O - 82 - 12

Fiscal policy, the Federal budget, the Federal Government's role in our economy, must continue to be reduced.

We are pleased, but we are not impressed with the $35 billion reduction, off of a proposed budget of some $725 billion, that the prior administration at the time of submitting that budget, admitted that it was a bloated budget; we are not particularly impressed with the $35 billion cuts, but we are very pleased that there was a reduction of $35 billion.

We are still not pleased that the Federal Government takes better than 20 percent of GNP. We have said since the White House conference, that that figure, that percentage, must be brought down to the 15 to 18 percent range.

Unless the economy grows, it would appear that that will happen. I think it must happen.

We think that the Federal Government takes far too much capital in the private sector. Primarily, they are taking it to pay the interest on the debt which now will pass $1 trillion.

We feel that must be reduced.

As to monetary policy, I feel that it is very hard to argue that we have a monetary policy in this country and that we have had a monetary policy in this country for some period of time.

We have seen wild fluctuations in growth of money supply and then a clamping down on that growth of money supply.

We have right now House Concurrent Resolution No. 133. It was passed in 1975, which set up in Congress a joint committee, House and Senate, to monitor the results of the Federal Reserve Board as to monetary policy. That is now public law and has been since 1975.

The essence, the bottom line, of that law says that the Federal Reserve Board will adhere to a monetary policy to allow the growth and supply of money which is consistent with the long-term growth of our economy. There is only one definition for that. That is 3- to 3½-percent. That is what it has been.

The Chairman of the Federal Reserve Board reports to the joint committee twice a year as to what progress is made, and what results have been achieved during the prior 6 months and what we can expect in the following 6 months.

I would say clearly the committee does not exercise or is not exercising any responsibility because there is no way that since the law was passed anybody can say we have come close to the 3- to 3½-percent growth in the supply of money in this country.

In fact, it has jumped from as high as 15-percent-plus in a given quarter and a negative 3 percent in another given quarter.

The end result, the cumulative result is something like an increase of 9 percent over that period of time then.

Clearly, inflation has come to haunt us on interest rates. If monetary policy, as defined by resolution 133, had been maintained, economists tell me, and I went to three of them, that today we could expect to be living in this economic mode. We would have prime interest rates at 7 to 8 percent today. We would have inflation at 4 to 5 percent; we would have an unemployment rate at 6 percent today.

In addition, during the 6-year period, that would have put restraints on our fiscal budget. There just would not have been all of

this paper money for the Federal Government to play with, if we had just done what that one resolution said. We did not.

Recent monetary policy of course is negative growth in the money supply. We state that we cannot pay for the sins of the past with this type of monetary policy. It is killing us to try. Our recommendation as to how do we get out of this mess; first of all, we make one clear simple statement to ourselves and to everybody: We are going to forget the past; it is done. We are not going to try to pay for those sins.

Second, we are going to, from this day forward, adhere to monetary and fiscal policy with or which is in Concurrent Resolution No. 33, adherent to those goals in that. If necessary, we say abolish the Federal Reserve Board and the whole system. If necessary, we will put an end to the Treasury, Commerce; we don't care.

We say finally that there must be accountability. We say there on the books right now are vehicles and avenues of accountability which are not being used. They are either known or they are consciously being hidden from view, which of those two, I will not touch.

Finally, the Federal Reserve Board was created by Congress; it can be controlled by Congress; it is a creature of Congress; and Congress does, indeed, have all of the authority it needs to do whatever it deems necessary with the Federal Reserve Board.

Thank you.

Mr. DAUB. What is your business going to look like a year from now?

Mr. KEENAN. My guess is that without some change, and I would propose that the change be a gradual type of change, because I think we cannot afford the roller coaster effect it would have and particularly since last year when it dropped to 13 percent and things took off nicely, leading people to believe that the same thing might happen in 1981, when it did not, many people were over-inventory, my company included.

What I need is a consistent policy of what Mr. Miller suggested, money growth, and a consistent reduction of the industries until they become more in line with the measurement, because the spread is so tremendous now between the 22 percent that you see I just recently paid and the advertised or published inflation of somewhere around 9½ to 10 percent.

That is a 12-percent spread. I cannot last another year at that rate, not in the condition I am in now; I could probably subsist with two or three people. I presently have nine in one of our companies and nine in another.

I would basically have to reduce the size of my company to include only myself, my father, my brother, and my son, four people.

All of the others who have been with me from the minimum of 7 years, many to 10, 12, 15 years, would have to go, because I just could not write their paycheck.

Mr. DAUB. Can you diversify in any way relative to your current capital base and not necessarily postpone the agony, but manage yourself through the next year or so?

Mr. KEENAN. Yes. I have done that. Much of what you saw, particularly to the loss, was based on construction and consumer products.

I have within the last year and a half made a major effort to work in the industrial market, particularly the railroads who are doing the energy business that we would expect to possibly grow.

Mr. DAUB. And you said get further away from home on this?

Mr. KEENAN. It doesn't matter——

Mr. DAUB. Other territory——

Mr. KEENAN. Yes, that is true. I designed and built a new machine that 18 months ago, I don't know why I was lucky enough to do it then, but I came on the market about the time this started to fall apart and I built and sold 10 pieces to the railroad that I never would have sold otherwise, but those machines, the last four were shipped, one to Pocatello; Idaho; one to Provo, Utah; one to Portland, Oreg.; and one to Los Angeles, Calif.

The machine before that was shipped to Oklahoma City. I have not sold a major machine in Omaha or Douglas County for probably 120 days.

The only income that I have had has been from renting equipment that either is used equipment or new equipment that I cannot sell so in order to get a day or two of income from it, I will rent it.

Mr. DAUB. Is the printing business OK?

Mr. MILLER. I have no complaints.

Mr. DAUB. No complaints.

To get a clarification for the record, the small business association meeting you went to last week in Kansas City, is that an outgrowth of small business chapters forming a more regional organization?

Mr. MILLER. It is.

Mr. DAUB. So it is clear on the record what that is.

Mr. MILLER. Yes, this particular group that I was with over the weekend is a subsidiary, they are under the umbrella of Small Business United.

Mr. DAUB. OK.

Mr. MILLER. Mid-Continent, there are a total of nine of these groups forming to Small Business United.

Mr. DAUB. Is it the opinion of Small Business United then by way of some formal statment that the Fed should be abolished or that it should be placed in another agency like Commerce or something to be more responsive, the pressure to bring more money or the pressure not to bring more money?

Mr. MILLER. The consensus was, well, there are several problems that we see. One of them is this pseudoindependence of the Fed.

Mr. DAUB. You say the consensus is that that is good or that is bad?

Mr. MILLER. That it does not exist, is the consensus. We grant historically——

Mr. DAUB. Excuse me, in fact, if it did exist, if it were independent like it should be, that would be all right?

Mr. MILLER. Then at least we are talking in a different ball game, but if we track historically what the Fed has done, it has gone along with the philosophy, efforts, the policies and the politi-

cal pressure of every administration under which it has operated. It is not independent.

Mr. DAUB. Your observation is that really over a period of time it really has been subject to the jawbone of the President?

Mr. MILLER. That is demonstrably provable, yes.

Mr. DAUB. I just wanted to find out where you are coming from.

Mr. MILLER. It is not an independent agency in the sense that it operates——

Mr. DAUB. I am struck by——

Mr. MILLER. May I——

Mr. DAUB. Yes.

Mr. MILLER. There is one more issue brought up in this meeting and it has been before some of us locally too and it does not immediately impact interest rates, but the issue is the financial markets as they are involving our economy.

We are seeing many large financial concerns, be they banks and insurance companies or whatever, who are positioning themselves to take full advantage of the removal of restrictions on interstate banking.

We are very concerned with that possibility and that it will then tend to concentrate the economic power within fewer and fewer hands of organizations, corporations, and so forth.

An example, just recently, Banco of Minneapolis announced the purchase of the Dial Finance Co. of Des Moines, some 400-plus branch offices in some 37 States then.

Chase Manhattan Bank recently purchased three large, very large, computer service companies, one in St. Louis, one in Salt Lake City, and one in Dallas, Tex., combined have something like 18 million customers on their computer banks.

These are computer companies who service small savings and loans, small banks in regional areas, and there are other instances where this type of position is now occurring, within the very large financial corporations, mostly of New York, Boston, Chicago, San Francisco.

Mr. DAUB. Because they can collateralize——

Mr. MILLER. Our feeling to it is and in this we have no data to support, but it is that it is on a par with DuPont's ability to take on Conoco.

Mr. DAUB. So what you are saying is that the interest rate, if you have this high precipitant cost of money, it stimulates the movement to this situation you just described, but you are not saying that you want Government to jump in and prohibit all of these kinds of connections being made.

Mr. MILLER. When I speak for the numerous groups, no, and I have not, I am personally opposed, if possible, for Government regulations.

I think that what we are saying, as this deregulation of the banking industry proceeds, let us watch it very very carefully and closely, not so much in competition for the dollar, the rate of interest that the savings and loan in Omaha, that the bank in Omaha, is permitted to pay its depositor, but as it pertains to contracting economic power into fewer and fewer hands, that area we would like to watch very closely.

Mr. DAUB. I appreciate that.

Did you have anything else, a question?

Mr. BEDELL. No questions. I have got the answer to a problem though.

Mr. MILLER. I would be interested in it.

Mr. BEDELL. I have a bill for a truly progressive corporate income tax. If you have a bill for a truly progressive corporate income tax, then instead of it being an advantage for big corporations to buy the movement, it would be a disadvantage for them because they're going to have to pay more taxes.

I can't get anywhere——

Mr. MILLER. Is that your bill, sir?

Mr. BEDELL. No.

Mr. MILLER. Do you have the number?

Mr. BEDELL. In the White House small business conference, there were more votes for a progressive corporate income tax than any other.

Mr. DAUB. Than a fixed.

Mr. MILLER. And that was No. 1 and No. 2 so far allows it——

Mr. DAUB. Right.

Mr. BEDELL. But the problem is that most small businesses think that if we raise these, the tax base to $100,000 or $200,000, we have solved the problem; we have not done anything at all toward the problem of big businesses from the top keeping, buying the ones further down, and my argument is that you have got to start all of the way down and go all of the way to the top then you have a truly progressive, and when you do, you have found or solved, in my opinion, this problem.

Mr. DAUB. It makes it less attractive for the small business to even want to sell in the first place, even if the rate was progressive, no doubt about it.

Gentlemen, we appreciate it. I really do believe that you made a contribution as an individual picture plus speaking into our record of broad and very contemporary sets of expressions by those that you have been working with the last week or two and it is appreciated.

I know of the work you do in the Small Business Council and your leadership, both of you. You are to be commended for taking time to participate today and we do appreciate it.

Thank you.

Were you folks waiting to say something in the record here?

Mr. LAMOTT. Not necessarily. I am a small businessman. I could put input in there if you have time.

Mr. DAUB. Can you do it in 60 seconds or so?

Mr. LAMOTT. Sixty seconds?

Mr. DAUB. Yes. At least tell us who you are and come on up for just a minute, because I sure want to try to accommodate you. We have just a couple of minutes.

Mr. LAMOTT. OK.

Mr. DAUB. What is your name for the record, sir? We would be very happy, but just remember the time is limited.

TESTIMONY OF JIM LaMOTT, USED AUTO SALES

Mr. LAMOTT. I am Jim LaMott. I am a small businessman. I am in used autos.

Two years ago, for instance, when the Federal Reserve put on their tight money policies, I had about 9 or 10 employees and now I have got about half, about 5.

Personally, in that particular length of time, I have lost about $100,000 which is a lot of money to me.

It is just a matter of time before myself and probably a lot of other small businessmen, I mean real small businessmen like myself, are just going to be to the bottom of the bucket and we are going to have to close our doors.

Mr. DAUB. Interest rates?

Mr. LAMOTT. Interest rates.

Mr. DAUB. That is the rub?

Mr. LAMOTT. That is the reason.

Mr. DAUB. What are you paying right now for your limit?

Mr. LAMOTT. Twenty at one place and 19 at another.

Mr. DAUB. If we said that interest rate was going to be 15, what would that do to help? Would that help?

Mr. LAMOTT. That would certainly help, but that is not all of the problem.

Mr. DAUB. What else is there to it besides that?

Mr. LAMOTT. In Nebraska, now we have user laws at 18 percent on installment of a civil contract that the dealer sells to the bank and 19 percent if the person goes in directly, then, to the bank and gets the money.

There is one of the big problems, in fact, one of the biggest. The amount of money that banks are having to pay for money to CD's for instance, the spread is so small between what they have to pay and what our user laws permit them to charge that they are very selective and in giving more money to buy merchandise.

Mr. DAUB. There are two things I want to say to you. One, is I want to say to you, I am going to call you and talk further, because of the time constraint now that we have; second, is it L-a-m-o-n-t?

Mr. LAMOTT. L-a-M-o-t-t.

Mr. DAUB. There is a guy over here in the back of the room that stuck it out and I don't know if you know Bob Bernier or not from the Nebraska Business Development Center, back over here, but I wanted you to get acquainted with him, because he has got skills and resources that are available to maybe help you hang on while we try, hopefully, together as a country and a Congress to get some of this under control.

I want to let him know about some of your problems and your ideas. I just wish we had a little more time.

Thank you for getting in the record very much and we will develop it from there, OK?

Mr. LAMOTT. All right.

Mr. DAUB. I appreciate your taking the time to be here today.

George Garnett, I have about 30 seconds for you. We had asked for you here a little while ago with North Omaha Community Development.

Mr. GARNETT. Right.

Mr. DAUB. Quickly, tell us hello and maybe you would submit something for the record in the next 5 days.

Mr. GARNETT. All right.

Mr. DAUB. Do that in writing, because we only have about 30 seconds to go here.

TESTIMONY OF GEORGE GARNETT, NORTH OMAHA COMMUNITY DEVELOPMENT

Mr. GARNETT. I am George Garnett with the North Omaha Community Development.

The only point that I want to make is the high interest rates encourage all of these processes of all of these problems in the economy. The problem with that is not only does that cut down on competition but it also eliminates areas from having any services which large corporations don't feel, in fact, are profitable and we work in areas such as that where it is not seen as a place where most of the business that exists is small business and it is basically breaking the backs of the small businesses.

Mr. DAUB. Thank you. Would you please give us your thoughts in elaborate detail, write them down?

Mr. GARNETT. I will.

Mr. DAUB. We will really appreciate that and I wish we had had you here a little sooner and then we could have had you on.

No problem, but just accept an apology from us for the limitation on our time. We are going to be going from here up to Sioux City, Iowa, to another set of hearings in just a few minutes.

Thank you. I will talk to you later.

Mr. Carl A. Shield is here who is a senior vice president and director of research at the Federal Reserve Bank in Chicago.

I have a dossier that he is a special adviser to Paul Volcker.

We just want to have you sit down and say Hi to us so you know we are not going to have but about a minute right now, but maybe you could answer this one question.

Do you see the commercial bank policy of discounting prime to major corporations continuing and, if so, for how long?

TESTIMONY OF CARL A. SHIELD, SENIOR VICE PRESIDENT AND DIRECTOR OF RESEARCH, FEDERAL RESERVE BANK, CHICAGO, ILL.

Mr. SHIELD. Let me simply suggest that when you are talking about the low prime loans, and you are talking about loans to corporations that are essentially overnight, very short-term loans or lending, 3 or 4 days, and they are not of the same kind of loans that we generally think about for longer terms or other types of firms as well.

I think that you will find that there certainly is a great deal of competition throughout the world when you are lending in those particular areas and those efforts are there, but as we begin to get inflation under control in the United States, and interest rates begin to come down, you will see less of that kind of activity in commercial banking.

Thank you.

Mr. DAUB. How do you rate the current climate for Federal Reserve tight money policy?

Mr. SHIELD. I think that it is important, if we can, to spend just a couple of seconds trying to say what do we mean by a tight money policy. High-interest rates are one way of looking at a tight money

policy. Frequently that is the way that it has been looked at, that is, in the United States.

The other aspect, however, is to look at it in terms of rates of growth of money, whether or not we in the Federal Reserve try to move toward a stable, lower rate of growth of money.

Additionally, we have known that rapid rates of growth of money precipitate and encourage inflation. There is a relationship between prices and the rate of growth of money.

So the policy of the Fed and its concern with inflation which is a concern that we have interpreted from Congress as well as throughout the United States that inflation is a major problem and we will be moving toward a lower rate of monetary growth.

The process of moving toward that lower rate of monetary growth in a society which has heavy inflationary influences in place, from the past, and quite frankly from the standpoint of from large deficits, that in mind that the financial markets are larger than those being planned or projected by the administration, mean that the pressures on interest rates have mounted.

As we move for some feeling that we are getting inflation under control, the actions of Congress, the administration and the Federal Reserve are moving in the same direction for reducing inflation, we have seen some signs of that, modest as they may be, and we see that the deficit, itself, may be smaller, and the same amount of money growth may produce smaller and lower rates of interest for the society and more rapid growth and development.

I must say that I have been listening here. I am sorry that I was not able to be here earlier to hear some of the comments, but there were some comments about negative rates of growth. Money has been growing. They are not negative. We have no intention of trying to strangle the economy.

We have been moving, in fact, over a period of years, if you use one measure of money, the so-called transactions made with a measure of M1-B, since the fourth quarter of 1979, money has been growing just a little under 5 percent.

If you use a broader definition of money, including money market funds, that many people do look at as having transactions capabilities, we are growing over 9 percent. So money has not grown stagnant. Money is not "flat" in terms of growth.

Mr. DAUB. Do you see encouraging signs that we are headed, even if slightly, in the right direction in terms of fiscal policy?

Mr. SHIELD. Certainly, the idea of the general thrust is, as I understand it, in terms of restraining spending, effectively looking at the tax cut side, the elements of the administration's program, in principle.

Mr. DAUB. Structurally.

Mr. SHIELD. It is the approach but we must go yet another year to get to inflation——

Mr. DAUB. I am so very pleased that the Feds have noticed. We wish that we had more time, but we will get better acquainted on our way to Sioux City.

Thank you very much.

The hearing is adjourned.

[Whereupon, at 5 p.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

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